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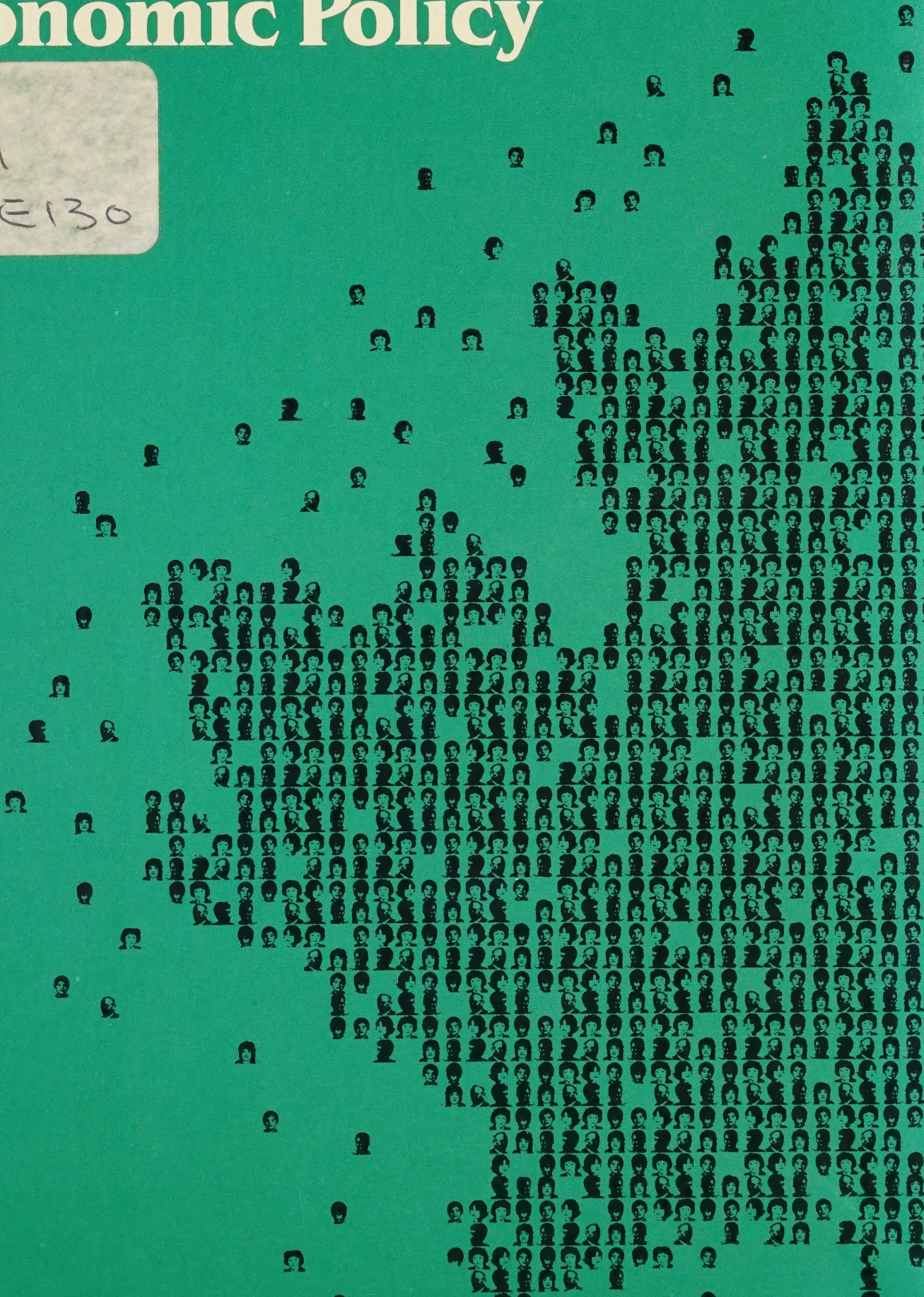
DENIS STAIRS and GILBERT R. WINHAM
Research Coordinators

Selected Problems in Formulating Foreign Economic Policy

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***Selected Problems in Formulating
Foreign Economic Policy***

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DENNIS STARR

AND

COLLETT B. WIDHIAN

Foreign Economics

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Selected Problems in Formulating Foreign Economic Policy

DENIS STAIRS
AND
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*Published by the University of Toronto Press in cooperation with
the Royal Commission on the Economic Union and Development
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When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's Research Program was carried out under the joint direction of three prominent and highly respected Canadian scholars: Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September, 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD



At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (over 280 separate studies in 72 volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, *Law and Constitutional Issues*, under Ivan Bernier, *Politics and Institutions of Government* under Alan Cairns, and *Economics* under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*
- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multi-cultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

Economics research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, how institutions and policies affect this allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of

what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald, the Commission's Executive Director, Gerald Godsoe, and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants, Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

IVAN BERNIER
ALAN CAIRNS
DAVID C. SMITH



PREFACE

The terms of reference of the Royal Commission on the Economic Union and Development Prospects for Canada required it to report on the “long-term economic potential, prospects and challenges facing the Canadian federation and its respective regions, as well as the implications that such prospects and challenges have for Canada’s economic and governmental institutions and for the management of Canada’s economic affairs.” With the world becoming at once more interdependent and more competitive, this was not a task that could be undertaken without reference to Canada’s place in the international economy, where “significant changes” were seen to be in progress. It was therefore determined that a portion of the Commission’s research program should be devoted to an analysis of Canada’s present situation and potential future in the world economy. Much of this work was naturally assigned to economists but, since the issues under investigation raised important political and institutional issues as well as economic ones, this section of research was therefore established to augment the work of other divisions on issues related to international trade and the legal environment.

The number of studies that could be initiated was limited by the resources available to the section, and ultimately it was decided that the research would concentrate, first, on the general environmental conditions within which Canada’s external economic policies must be made; second, on the all-important economic relationship with the United States; and third, on an examination of various problems of substance and process in the making of Canadian foreign economic policy. With the partial exception of policies bearing on the economic problems of the Third World, which were being considered in some depth elsewhere, Canada’s economic relationship with other countries appeared not to raise political and institutional questions as important to Canada as those with the United States. Because of a

limited research budget, therefore, they were not made the subject of specific studies. The papers that have resulted from this section of the Commission's research program are being published in three separate volumes, as listed here.

**Volume 28: Canada and the International
Political/Economic Environment**

Denis Stairs and Gilbert R. Winham	Canada and the International Political/Economic Environment: An Introduction
Jock A. Finlayson	Canadian International Economic Policy: Context, Issues and a Review of Some Recent Literature
Michael C. Webb and Mark W. Zacher	Canadian Export Trade in a Changing International Environment

**Volume 29: The Politics of Canada's Economic
Relationship with the United States**

Denis Stairs and Gilbert R. Winham	The Politics of Canada's Economic Relationship with the United States: An Introduction
J.L. Granatstein	The Issue That Will Not Go Away: Free Trade Between Canada and the United States
Kim R. Nossal	Economic Nationalism and Continental Integration: Assumptions, Arguments and Advocacies
Charles Pentland	North American Integration and the Canadian Political System
Jock A. Finlayson	Canada, Congress and U.S. Foreign Economic Policy
Gary C. Hufbauer and Andrew J. Samet	U.S. Response to Canadian Initiatives for Sectoral Trade Liberalization, 1983-84

**Volume 30: Selected Problems in Formulating
Foreign Economic Policy**

Denis Stairs and Gilbert R. Winham Gerald Wright	Selected Problems in Formulating Foreign Economic Policy: An Introduction Bureaucratic Politics and Canada's Foreign Economic Policy
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Robert Boardman

The Foreign Service and the Organization
of the Foreign Policy Community: Views
from Canada and Abroad

F.J. Chambers

The Emerging Cost Structure of Canadian
Firms: Some Implications for International
Economic Policy

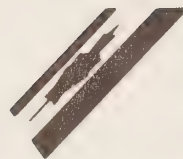
R.B. Byers

Canadian Defence and Defence
Procurement: Implications for Economic
Policy

DENIS STAIRS

AND

GILBERT R. WINHAM



ACKNOWLEDGMENTS

The editors acknowledge with gratitude the continuing interest shown by Research Director Alan Cairns in the section “Canada and the International Political Economy.” The combination of his demanding standards and supportive leadership helped to raise the quality of the research papers produced in this section. Further thanks are due to the Commission staff who performed an essential role in bringing these papers to fruition, namely Karen Jackson, Research Program Advisor and Assistant to Dr. Cairns, who managed the logistics of the research station, and Françoise Guilbault, who ably discharged the varied secretarial tasks associated with the section.

In designing these studies the editors were assisted by a Research Advisory Group, which individually or collectively commented on many of the manuscripts included in the section. Their varied expertise on matters of international political economy was a valuable asset in providing ideas and criticism to individual authors. Members of the Research Advisory Group were as follows:

Professor Louis Sabourin
École Nationale Administration
Publique-GERFI

Professor Eric Kierans
Dalhousie University

Mr. Michael Hart
Department of Transport

Professor Rodrigue Tremblay
Université de Montréal

Professor David Leyton-Brown
York University

Professor Jeanne Laux
University of Ottawa

Professor Gerald K. Helleiner
University of Toronto

D.S. AND G.R.W.



Selected Problems in Formulating Foreign Economic Policy: *An Introduction*

DENIS STAIRS AND GILBERT R. WINHAM

The papers in this volume represent a variety of concerns in Canadian foreign economic policy making. The first two pieces, by Gerald Wright and Robert Boardman, deal with the process of policy making and reflect the fact that how government policy is made can be as important as what substantive decisions are reached. The second two papers, by Fergus Chambers and R.B. Byers, are case studies of issues that bear on foreign economic policy, but go beyond the usual subject matter treated in this context. Chambers examines the pressures on government policy that can arise in the private sector and may call forth a response from government in the future. Byers analyzes policy making in defence and defence procurement, which has substantial implications for the economic welfare of Canadians and for Canada's foreign economic policy vis-à-vis other nations, notably the United States.

The Process of Policy Making

Foreign economic issues involve a large number of diverse interests in society. Consequently, as Boardman has noted, foreign economic policy is likely to be characterized by conflicts between government departments. Such conflict is an inescapable part of the process of government policy making, and it has come to be characterized by a term that is familiar to all modern observers of the practice of government, namely bureaucratic politics.

To some extent, bureaucratic politics in the policy-making process are no more than an institutional manifestation of the many preoccupations of the domestic constituency. The government agencies involved may thus be regarded essentially as the articulators of the various pros and cons that must be taken into account. But years of study by political scientists,

organization theorists, and public administration specialists, working in a wide variety of fields, have established very clearly that when the weighing of competing considerations is bureaucratized, extraneous elements begin to affect the result — among them the desire of each bureau to protect its turf, amplify its power, and make the most of its political resources to ensure that primacy is given to its mission. Moreover, the process of give-and-take that is inevitably involved in the resolution of policy conflicts can itself have an impact on outcomes, causing them to deviate from what a detached observer might regard as rational. Government organization is therefore not simply a matter of efficiency; it is also a question of priorities and power. From the point of view of the political leadership, moreover, there is an additional practical problem in that policy processes of this kind can be very difficult to control from the top.

In light of these considerations, Wright offers an interesting assessment of how Canada's governmental apparatus actually manages a coherent economic policy abroad, within the bounds of public accountability found in a parliamentary system. His paper is candid, revealing and often critical of the procedures followed in Ottawa in the making of foreign economic policy. It contributes to an understanding of bureaucratic politics by showing how they are related to policy issues, for it is obvious from his account that bureaucratic politics are more associated with trade policy than with international monetary policy. Furthermore, Wright has integrated the analysis of bureaucratic politics into the framework of parliamentary government, for despite his observation that "the basic fault lines in the government are still governmental," he has demonstrated how relationships between ministers and their bureaucrats can greatly influence policy making.

A related but somewhat more narrowly focussed problem arises in the context of the foreign service itself, which is the subject of Boardman's paper. Foreign services in Canada and elsewhere have been increasingly required in recent years to deal with complex issues which have involved the responsibilities of other departments of government, and which have tested the service's own technical expertise. The result has been that the role of the foreign service officers and the practical utility of the traditional diplomat have been called into question. Should foreign service professionals be differently organized to meet these changing requirements? Should they be differently trained and tasked? Has the character of the knowledge they must possess been profoundly altered? To what extent can — or should — the Department of External Affairs be regarded as the appropriate coordinating agency within the government for the pursuit of economic objectives in the international environment?

This combination of organizational and professional issues has led in recent years to reassessments of the role of foreign ministries in almost every western country — Britain, France, the Federal Republic of Germany, the United States, and Australia among them. The Canadian Department

of External Affairs has been reorganized more than once — to the point in January, 1982 of being completely amalgamated with the trade commissioner service. Boardman's paper reviews this reorganization in the context of a more general analysis of western foreign offices and their capacity to adjust to the changing policy environment. The author notes that, unlike the more gradual readjustments that are the rule in most countries, the external affairs reorganization was a sudden change in an effort to provide Canada's foreign office with a greater capacity to conduct foreign economic policy. Boardman's analysis is a helpful attempt to situate the Canadian experience in the context of wider problems facing western democracies, and it serves as a reminder that the problems of foreign policy coordination that Wright identifies are shared by Canada's economic partners as well.

The basic issue in the External Affairs reorganization was the tension between coordination and expertise in foreign policy. This tension is part of the broader gulf between process and substance in policy making — that is, the need to ensure that the widest number of officials whose interests may be touched by a policy matter are involved, versus the need to ensure that the content of policy represents the most timely and appropriate action that could be taken in the situation. The need for "process" in policy making is obvious; yet when it is carried to an extreme, it can result in timid or mediocre results. Such policy making often earns the epithet of "process-driven."

In Canada, it was argued that if External Affairs were to exercise fully its mandate to coordinate and implement foreign policy, the Department needed to increase its capacity to analyze and conduct foreign economic policy. As Boardman notes, this situation has been faced in other nations, and the outcome has often been different from the Canadian experience. For example, in West Germany, the Finance Ministry has important influence over trade policy and other matters of international economic policy. In Australia, the Department of Trade and Industry has had more influence over shaping international economic diplomacy than has the Department of Foreign Affairs. And finally, in Japan — the OECD nation with the most envied trade performance in the postwar period — a separate Ministry of International Trade and Industry (MITI) operates nearly autonomously from other ministries, including Foreign Affairs, in most matters of trade diplomacy.

As Wright has pointed out, Canada's foreign economic policy machinery does not appear to be operating effectively at the present time. It is therefore possible that Wright's recommendations for change may be one of a series of proposals for organizational reform that could come forward over the last half of the 1980s. In any thinking about how to reorganize yet again the federal bureaucracy to conduct economic diplomacy, one experience appears to surface frequently as an example of a period when the process worked well, namely, the operation of the Canadian Coordinator for Trade Negotiations (CCTN). The office of the CCTN was established in 1977 as

a response to the external pressure from the Tokyo Round negotiation, and it was an effort to streamline internal Canadian decision making in order to allow Canada to negotiate effectively externally. By all accounts, the CCTN was exceptionally successful. Many have argued that the success of this structure was due to the personal ability of the coordinator himself, an argument which incidentally offered a rationale for discontinuing the CCTN when he left following the Tokyo Round. Without detracting from his skills, which were considerable, one should note that the CCTN had the instruments that Wright has indicated are necessary for bureaucratic influence: formal authority, a clear mandate, and staff resources. Furthermore, and of even greater importance, the coordinator had direct access to a powerful minister and hence to cabinet decision making. Such access was crucial for managing relations with provincial bureaucracies and the private sector. Indeed, what existed in the CCTN were the beginnings of a federal department of international trade.

The CCTN was dissolved following the Tokyo Round. One result of this action has been to diminish the provincial role in Canadian trade policy, at a time when most observers are in agreement that provincial barriers are becoming more important in the overall trade picture. Another result was reduced communication between the private sector and governmental policy making which was further exacerbated, as noted by Boardman, in the External Affairs reorganization of 1982. In dropping the CCTN, Canada took an action that seemed at variance with its major trading partners, who tended to continue those negotiating and decision-making structures that had worked well during the Tokyo Round. For example, in the United States a novel system of sector advisory committees met with considerable success during the negotiation and was subsequently retained. Moreover, in amalgamating the trade function into the foreign office, Canada has certainly given less bureaucratic autonomy, and arguably less importance, to trade policy than do most of Canada's major trading partners. Normally, national governments create bureaucracy to reflect the underlying concerns of the societies they serve. It is surprising that Canada has declined to establish a ministry of external trade at the federal level, for after Belgium and the Netherlands it has one of the highest exports-to-production ratios of the OECD nations.

The early 1980s have witnessed considerable discussion over whether Canada would initiate negotiations with the United States to liberalize bilateral trade with that country. The outcome of such negotiations would be profound in terms of Canadian trade policy, and it would put pressure on the Canadian government to increase the effectiveness of its policy machinery, probably leading to further structural changes in that machinery. This could create both problems and opportunities as Canada prepares to debate the advisability of making an historic shift in its trade policy. Thus structure, process and substance are often related in foreign economic policy making.

Case Studies in Foreign Economic Policy

No country can make foreign economic policy with a free hand. All are constrained by circumstances to one degree or another, and much of policy making is a matter of intelligently adapting to those constraints. Because Canada competes for resources and especially for markets in the international economy, the most visible constraints of foreign economic policy are often external. Thus one might see Canadian businesses and policy makers constrained by, for example, international surplus capacity in certain mature manufacturing industries or by the development of competing commodity industries in developing countries.

Moreover, internal constraints can reduce the federal government's ability to develop new foreign economic policy directions. These would include government procurement procedures, resource ownership by provinces, and the considerable control by the provinces over the education and certification of significant parts of the labour force. Indeed, the whole spectrum of federal-provincial economic relations is a limiting factor that often must be taken account of when Canada negotiates economic issues with other countries, or when it unilaterally establishes new policies for dealing with economic issues at the international level.

The paper by Chambers examines the constraints and demands that may be imposed on Canadian foreign economic policy as a result of changes that have occurred at the microeconomic level. It is apparent today that the Canadian economy has changed substantially over the past two decades, and that the changes create new circumstances for economic foreign policy. The economy has become much more open than it was previously because of reductions in tariffs, changes in technology and reductions in transportation costs. Moreover, Canadian manufacturers can no longer count on a secure domestic market for their products, which means that access to foreign markets has become as critical for central Canadian manufacturing as it has always been for the resource industries and the regions of Canada. Thus internal political pressures on trade policy may change, and the traditional regional differences of opinion on the merits of free trade and protectionism may diminish since both resource industries and manufacturers will want access to foreign markets. Moreover, the debate between proponents of a multilateral approach and those who favour a more focussed concentration of Canada-U.S. trade arrangements may become much more intense.

In this context, Chambers' argument shows how new technologies and the international environment interact with microeconomic decision making in firms, and how such interaction can shape the political demands made by business firms and labour in the Canadian system. The argument is a careful and logical extrapolation of the effects that changed economic circumstances can have on the political system. The paper is useful because it provides a structure that explains certain developments that have occurred

recently in the Canadian economy. For example, why is there now so much pressure from the business community for freer trade, as evidenced by the hearings before this Royal Commission? Chambers' analysis of the cost structure of firms, of the opportunities involved in specialization and world product mandating, and of the limitations of the Canadian market, helps answer this question. His paper also leads to an understanding of the Canadian Manufacturers' Association, which has historically been a protectionist organization but has recently published a report sympathetic to freer trade.

The most interesting part of the analysis is the author's description of the impact of economic groups on the political process. Led by many academic economists, we are accustomed to think of the economy in terms of sectors, and indeed much government policy is sectoral in nature. However, Chambers focusses on the firm and shows that the pressures on government can vary substantially within sectors, depending on how firms (and their associated labour unions) have met the challenges of a more competitive environment.

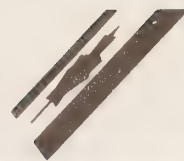
While Chambers' paper deals essentially with the implications for Canada's economic policies abroad of microeconomic pressures at home, Byers' paper is concerned primarily with the implications for domestic policies of the politico-security environment abroad. International security conditions are obviously at the heart of government expenditures on defence. The Canadian government is in an unusually fortunate position, however, in that Canada faces no direct external threat to its security for as long as it is able to maintain a fundamentally amicable relationship with the United States. It would certainly be vulnerable to devastation in a military exchange between the United States and the Soviet Union, but it is generally understood that Canadians do not have the capacity to exercise more than a marginal influence on the East-West balance of military power. To the extent that their security is to be obtained by military means, therefore, it is afforded by the American strategic umbrella. It is for this reason that Canadian defence analysts have been known to argue that Canada's defence problem is that it has no defence problem, and to suggest that the real need is for a "defence against help" — that is, a sufficient military capability to ensure that the Americans do not attempt to violate Canadian sovereignty to make certain that the job of securing North America's defences is properly done. It is for this reason as well that Canadian contributions to Western defences outside Canadian territory have been designed more for their diplomatic than for their military effect. The Canadian role in NATO, for example, has been intended as much to influence allies as to deter opponents. Given these general circumstances, and in the absence over the past two decades of an acute and prolonged security crisis, the temptation has been to allow the armed forces to run down.

These realities are carefully documented in the Byers paper. But the budget of the Canadian Forces is nearly \$9.5 billion dollars per annum, and

accounts for over 9 percent of total government expenditures. Taking into account the fact that many of the government's financial obligations are fixed by statute or result from commitments that cannot be altered, some analysts have estimated that these figures represent as much as 40 percent of Ottawa's capacity for "discretionary" public spending. Even in terms of the GNP, this is not an insignificant sum. For particular communities, it can mean their economic survival.

The economic implications of government spending on defence can be especially important in relation to programs for the procurement of capital equipment. After a long period of neglect, the need to replace major items of military hardware will create a bulge in procurement expenditures over the next decade or more, and in a period of renewed Cold War tensions these may be amplified and accelerated by demands from allies for improvements in Canada's level of military preparedness. Anxious to maintain their diplomatic credibility in Washington and elsewhere, Canadian policy makers may feel obliged not merely to modernize their military capabilities, but to expand them. If past practice is any guide, however, the expenditures that result will be affected as much by domestic considerations as by foreign policy objectives. These may include minimizing adverse effects on the balance of payments, reducing unemployment, promoting indigenous research and development in areas of sophisticated technology, expanding the domestic industrial base, and responding to the need for regional economic development. So high a priority has commonly been given to these secondary purposes of defence procurement spending that some authorities have complained of their being pursued at the price of eroding the real value of the military capabilities that ultimately ensue.

Byers' detailed review of Canada's overall defence spending and procurement practices illustrates the tension between the economic and military considerations underlying government policy. His analysis of Canadian defence industries indicates that at present they occupy a relatively small position in the economy as a whole, but are heavily engaged in Canada-U.S. trade and play an important role in certain specialized industrial sectors. In assessing the results of existing procurement strategies, the author concludes that significant changes are required if forthcoming investments in capital equipment for the armed forces are to be effective in advancing both the military and the economic objectives of government policy. Among the proposed adjustments is an abandonment of the present practice of seeking industrial benefits for Canada by insisting that contracts with foreign suppliers be accompanied by "offset" provisions and countertrade guarantees. In the long run, he suggests, Canada's military and economic requirements alike would be better served by a less protectionist approach, possibly accompanied by a revitalization of defence production sharing agreements with the United States.



Bureaucratic Politics and Canada's Foreign Economic Policy

GERALD WRIGHT

The Interdependence of Policies

The growing sensitivity of nations to developments beyond their borders has engendered an awareness of the interdependence of the goals and instruments of foreign economic policies. It is now acknowledged that the achievement of national goals in one area is almost always dependent on developments in another. Action taken by a Canadian government to protect a particular industry would, for example, risk retaliation by foreign governments. A higher value for the Canadian dollar would drastically affect the immediate prospects for Canadian exports of some natural resources. A Canadian government seeking to restrict the inflow of foreign capital would have to open up foreign markets for Canadian manufactured goods, so that the country's chronic current account deficit could be diminished. Similarly, a serious effort to tackle the problems of debt-ridden developing countries would have to embrace both trade and financial policies, since debtor countries can work their way out of their morass only by selling goods abroad.

Just as it has become impossible to compartmentalize Canadian policies aimed outside the country, the link between foreign and domestic policies inside the country has been tightened. This is particularly noticeable in trade issues, which have become intertwined with industrial policy and thereby bound up with employment, regional development and many kinds of social policy. As a result, foreign economic issues have been pushed higher on the Canadian domestic political agenda, and politicians have become more involved in what was formerly the almost exclusive domain of government officials.

This paper is an analysis of the formulation of Canada's foreign economic policy from the perspective of bureaucratic politics. It is intended to illu-

minate the relation between the process of policy making and the substance of policy. The newly perceived interdependence of foreign and domestic policies has complicated policy making, introduced new modes of cooperation and conflict, and blurred the mandates of the organizations already set up to handle economic policy. This has created the necessity for new mechanisms and brought about marked changes in the ways officials behave toward each other. In turn, officials have had to acquire expertise different from that which they needed before, and their career prospects have been transformed radically. The consequent greater intensity of bureaucratic life is one reason that bureaucratic politics can afford a useful mode for examining foreign economic policy.

The Bureaucratic Politics Approach

An Analytical Perspective

Bureaucratic politics provide an analytical perspective through which to view the decision-making process in government.¹ In this perspective, the process amounts to a series of overlapping games in which a number of players participate. The players may be politicians, newspapermen or interest group spokesmen, but the central characters usually hold important jobs in the bureaucracy. Each game is played according to rules that stem from legislation, convention and the political culture, and these rules prescribe which officeholders are to be players, the powers attached to their respective offices, and the parameters within which they must act. The game is brought to a conclusion through bargaining, compromise and the formation of coalitions; the outcome is the combined result of the manoeuvring of all the players. Adherents of the bureaucratic politics approach claim that an analysis of the game provides an insightful explanation of governmental decisions and actions.

What determines the positions that are taken in the bureaucratic game? Underlying the bureaucratic politics perspective is the assumption that the national interest is only one component in the calculations of individual players, along with organizational and personal interests. The way each player views his world will be conditioned by a set of parochial priorities, perceptions and attitudes. A trade bureaucrat is, for example, going to have a different background and perspective, a different set of axes to grind and a different audience assessing his performance, than an official of the Bank of Canada. Different departments see the same issues differently, depending on their fundamental missions, the attitudes that have been ingrained by past experiences, and the pressure groups outside government with which they interact frequently, and whose interests they often seek to serve.

What determines the effect that each player has on the outcome? Bureaucratic politics place a premium on the skill with which formal authority, expertise and information are exploited. Effective bureaucratic players have

good timing, an aptitude for sizing up an adversary, bargaining ability and persuasive power; without these talents, their other merits count for little in the policy-making process.

In the perspective of bureaucratic politics, it becomes important to comprehend the nature of the game. Depending on the rules in force, some arguments will be convincing, some manoeuvres will be considered legitimate, and some players will have influence and power. The players soon grasp the difference that the rules make, whereupon the rules themselves become an object of contestation. This is particularly the case when some departments are trying to gain a foothold in the policy process and others find it to their advantage to keep the process restricted to as few participants as possible. Whether an issue is contained and resolved within a single bureaucratic structure, or whether it is subjected to bargaining and competition between departments and to the coordination of a central agency, can after all make a considerable difference to the policy outcome.

Bureaucratic politics do not have to get out of hand, but our attention is certainly drawn to that possibility. Rational and democratic government cannot permit the decision-making process to become an uncoordinated game in which the players act solely out of selfish personal motivations, the result depending on the power and skill of individuals regardless of the merits of the case, and the policy objectives lost sight of altogether in the general chaos. This paper is, therefore, partly aimed at discovering whether there are abuses in the making of Canada's foreign economic policy that can be attributed to bureaucratic politics. Just as important are the lessons that can be learned by political leaders who seek to take control of the governmental machine and who will be unable to manage issues successfully and to shape effective decision-making structures unless they understand the games that bureaucrats play.

It is sometimes claimed that the system of constitutional checks and balances in the United States invites bureaucratic politics, whereas in Canada the institution of cabinet government and the pervasiveness of the career principle in the public service tend to do the opposite. In fact, in the area of foreign economic policy, Canadian officials are not constantly engaged in bargaining, conniving and competing, and this area is not particularly noted for hard infighting or frequent disputation. There is, however, ample scope for the exercise of influence by bureaucrats in the Canadian political structure, and this does have an impact on policy, though there is also more restraint and willingness to compromise than is exhibited by bureaucrats in the United States. The predominant flow of influence may be lateral or vertical, directed to gaining the support or blunting the opposition of other bureaucrats, or to changing the minds of ministers or mobilizing the energies of subordinates. What does sharply distinguish the Canadian case from the American is that the central role of the Cabinet in Canada means that, to a considerable extent, bureaucratic politics are hidden from public view.²

culture's acquisition of jurisdiction over the 1982 Meat Import Act, even though the minister of agriculture is required to consult with the minister of trade before taking restrictive action against beef imports. By the same token, having to make use of the legislation of other departments, as in the case of sectoral departments asking External Affairs for action under the Export and Import Permits Act, makes essential a degree of good inter-departmental relations.

A bureaucrat's constituency outside government will carry clout within, provided that it also weighs heavily with ministers. The trade official who could claim that behind him were "the textile and clothing guys and the Liberal caucus" had a distinct advantage in the battles over quotas in the 1970s and early 1980s. In response to such a claim, the geographic division in External Affairs which can only argue the importance of good relations with a foreign trading partner will be at a distinct disadvantage. If, however, Canadian exporters are aroused, as they have been recently over restrictions applied to imports from Indonesia, that can also be a considerable weight in the balance.

Expertise is a vital prerequisite for laying claim to a policy area and, consequently, hiring new expertise is an integral element of the bureaucratic game. How a deputy minister settles a turf issue with significance consequences for policy, such as whether External's Asia and Pacific branch or economic and trade policy branch will lead on the issue of Japanese automobile imports, will quite often depend on which contender has the appropriate capability. Likewise, the defence of territory is made infinitely easier by the possession of expertise; the Bank of Canada and some divisions in Finance preserve their autonomy partly because of their almost exclusive mastery of their respective subject areas. Substantive expertise combined with drafting skill is a particularly vital asset. As the automobile imports case, which is described below, also illustrates, being able to produce an initial draft and getting discussion to focus on it is a favourite means of moving interdepartmental meetings in the desired direction.

The status of a department or individual greatly affects the attention that is paid to initiatives that they sponsor. One reason that preparations for the annual Economic Summit afford External Affairs some useful leverage, for example, is that the prime minister's personal sponsorship discourages senior officials from sending proxies to the preparatory meetings and makes it easier than usual to generate a consensus. Similarly, among central agencies, the Department of Finance, which enjoys high status because of its longtime central role in economic policy, has been much more successful in attracting high-level representation to its meetings than the now-defunct Ministry of State for Economic and Regional Development (MSERD).

The reputation of a department likewise influences the seriousness with which its words and actions are taken. The kind of reputation that serves well in dealing with other departments is one that combines firmness and capacity with a degree of flexibility. All participants in trade policy making,

for example, agree that Consumer and Corporate Affairs lost its influence in the 1970s because it adopted a purist stance and became too shrill in debate. Another example of the importance of reputation is the premium that is placed on the impartiality of ministers and officials attempting to fill a coordinating function. At various times a reputation for impartiality has served to enhance the roles of Finance and External Affairs and, conversely, one of the significant failings of the erstwhile MSERD was that it became too pro-active and embroiled in the issues confronting it.

Personal reputations matter tremendously at all levels of the bureaucracy, but particularly at the level of deputy minister. Officials almost instinctively identify the character of individual departments with their respective deputies. A bureaucrat acting on behalf of a deputy reputed to be a strong player in interdepartmental politics carries more clout than when the deputy is known to be weak or uncomfortable in dealing with other departments.

Finally, mandate is both a concrete and an elusive source of bureaucratic influence. In a formal sense, it is the prime minister's job to define ministerial mandates. After a Cabinet reorganization, mandate letters go out to the new ministers and, if necessary, the prime minister determines who will be lead minister in a particular case. In an informal sense, there can be considerable argument about who has a mandate and exactly what it says. A prime ministerial speech or other statement of government policy will be zealously mined and mined again in an effort to bolster the legitimacy of an opinion being expressed in interdepartmental debate. Bureaucrats also vie to shape and reshape mandates that will give them a claim on resources. The assistant deputy minister whose present responsibility is to push Regional Industrial Expansion into the thick of trade discussions must, for example, ensure that his department's annual strategic planning document includes a clear statement that trade policy is a departmental priority. Otherwise, he will be unable to get his colleagues with sectoral responsibilities to make available the specialists and the analysis that he requires.

Using international meetings to open up discussion of a subject that others, particularly ministers, would prefer to avoid is a tried and true bureaucratic technique and one reason for bureaucrats' enthusiasm for bilateral committees linking Canadian and foreign governments. Impending meetings force a review of policy and provide the excuse for getting instructions and a mandate. For example, prior to the 1982 Ministerial meeting of the General Agreement on Tariffs and Trade (GATT), a senior official in External Affairs managed to get the minister of agriculture to agree that the desirability of tighter rules governing the terms and conditions of access for farm products should be on the agenda. Extracting such an agreement from the agriculture minister was no mean accomplishment because, when it comes to agricultural trade subsidization, Canada's hands are by no means clean. Thus, the right to represent the country in international forums is a prized tool of bureaucratic influence.

There are two elements of bureaucratic politics that should be elaborated in the context of policy making in Canada. These are the importance of territory as a goal in the bureaucratic game, and the sources of influence available to players in the game.

The Importance of Territory

Canadian bureaucrats argue over legitimate policy differences but, at the same time, they are quite often disputing which organizational unit is going to be permitted to take charge of an issue. In examining a particular case, it often is impossible to separate these two motivations. When an organization must do battle for its views, its maximum and minimum objectives will be at least partly shaped by institutional self-preservation and institutional self-aggrandizement. In addition, there can be personal stakes in the game, such as career advancement, the chance for a more interesting assignment or the opportunity to be rid of an onerous burden, or objectives pursued by virtue of a bureaucrat's membership in a specific group. Though personal ambitions do play a role, territorial ambitions are easier to discern, being identified with whole departments and often stretching back many years.

The focus of this paper is, therefore, on the interrelationship of policy and organizational goals, on differences over "turf" and how territorial issues intersect with, and have an impact upon, the substance of policy.

The simplest form of territorial issue concerns who is to have what resources and responsibilities. At the time of the break-up of the Department of Industry, Trade and Commerce in 1982, for example, External Affairs and Regional Industrial Expansion contested the possession of the food and agricultural products branch, a dispute which drew in the Departments of Agriculture and Fisheries and which eventually had to be submitted to the Privy Council Office for decision. External Affairs was awarded international marketing responsibilities for all agricultural and food products, and the other three departments acquired the branch's programs directed at the development of their respective sectors. Beyond such disputes over resources and responsibilities, much of the bureaucratic politics involved in the making of international economic policy turns on the degree to which different policy areas are seen to be interrelated. Such interrelationships provoke arguments over turf. The overlap of policy areas at times makes it imperative for one actor to invade the territory of another, at other times necessitates entreating other actors for their support, without which rational and coherent policy will be impossible, and at still other times drives the actors to become more insular, defensive and protective of their prerogatives.

The importance of turf in international economic policy making in Canada has been highlighted by recent government reorganizations. When, for example, the head of the United States branch of External Affairs argues that responsibility for the Canada-U.S. energy consultative mechanism

should be vested in him, rather than in a functional assistant deputy minister, the issue quickly acquires added importance as a test case of whether, in the newly reorganized department, geographic branches are going to be allowed to lead on bilateral issues. Furthermore, new reorganizations are being mooted almost daily, and this makes each contest important to the contenders because it is both an indication of what the last reorganization is going to mean in practice and a possible determinant of the shape of the next one.

All members of a government department are not protective of its turf and covetous of that of others to the same degree. There are occasions when the competent and far-sighted are prepared to give ground in recognition of a higher national purpose, and when the less self-confident and less competent fall back on their territorial instincts.³ The position an individual occupies in the bureaucratic hierarchy also makes a considerable difference. Interdepartmental coordination in Ottawa is largely conducted by, or under the command of, assistant deputy ministers. They are the chief points of contact for their departments with other departments and are in constant communication with their opposite numbers. They are, in many cases, candidates for promotion to deputy minister, and so operate under the watchful eye of the Privy Council Office, which is in charge of all order-in-council appointments, and is inclined to take a black view of officials who fall short of being "total government persons." In other words, assistant deputy ministers have an incentive to get along with their counterparts throughout the government and to make an effort to understand each other's point of view.

More junior officials, however, whose efforts are frequently directed to developing the departmental position on an issue, and who have few sustained contacts with other departments, are inclined to a much more parochial perspective. By the same token, they are much more likely than assistant deputy ministers to adopt a turf-defending point of view and to interpret the actions of other departments, and of their own superiors, strictly in terms of the ambition to protect and extend territory.

Sources of Influence

How does one actor become more powerful than another in the bureaucratic game? What are the sources of the influence or clout that are brought to bear in intra-governmental politics? There are at least six that pertain to the field of international economic relations: legislation, constituency, expertise, status, reputation, and mandate.

To point to undisputed legislative authority is the surest way to shut off argument. Departments guard their enabling legislation jealously and are loath to see other departments equip themselves with competing legislative instruments. External Affairs is, for example, unenthusiastic about Agri-

The Main Actors and Their Roles

Before exploring the interplay of bureaucratic influence it is necessary to describe the roles of the main actors in international economic policy making, as these roles are laid down by legislation and mandate. In turn, the roles are closely linked to the underlying orientations manifested by each agency or department toward the interdepartmental process.

The orientations are not just the product of ingrained habits and traditional perspectives. Individual personalities have had a considerable part in shaping them, particularly in the case of those units that have remained immune from Ottawa's penchant for frequent reorganization. This would certainly hold true for both the Department of Finance and the Bank of Canada.

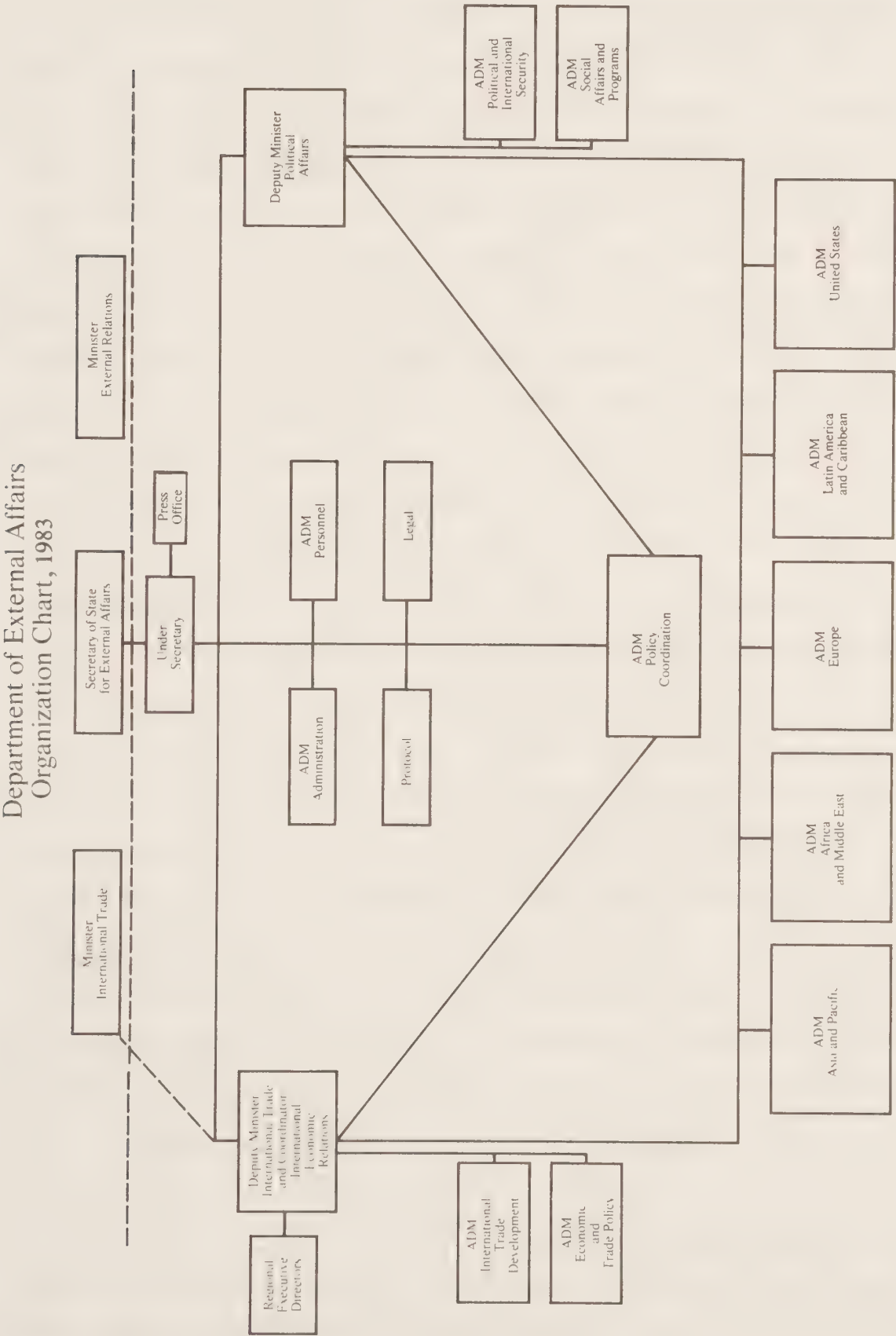
The Department of External Affairs

External Affairs is a hybrid department of state whose role can be understood only in light of the reasons for the governmental reorganization in early 1982. Not far into the 1970s, "old" External Affairs lost the last in a fairly long line of senior officials with experience and expertise in economic affairs. Meanwhile, other departments, particularly Finance, Defence, Energy and Agriculture, were forging their own international links with little more than a semblance of coordination with External Affairs. During the decade, the department increased its capacity in economics at the junior and middle levels and made various efforts to achieve better coordination of policy formulation, together with some integration of foreign operations.

The failure of those reforms to add substantially to External's clout prompted the government to consider how to infuse new energy and influence into the department. What particularly argued in favour of taking this course was the increasing conviction that the 1980s and 1990s would, in the words of one senior official, be a period of "crunching integration" in the world economy. Questions were looming about how Canada would be affected by an evolving redistribution of world economic activity, and there were increasing doubts as to whether External Affairs had the players to tackle such questions. It was treated as a matter of national survival that the department's capacity in economics should be increased substantially.

The reorganization of the department, preceded by a further consolidation of the foreign service in 1980, fulfilled the twin objectives of bringing trade into the centre of foreign policy making and awarding External Affairs a monopoly on the delivery of services abroad. The trade side of Industry, Trade and Commerce (ITC) was amalgamated with External by means of a complicated structure of criss-crossing lines of responsibility converging on three cabinet ministers (see Figure 2.1). To add to its general mandate

for the management of international negotiations and foreign relations, the new department was given broad responsibility for trade policy and trade development, and for the negotiation and administration of quotas under the Export and Import Permits Act. With its newly unified capacity, External Affairs was intended to be able to tell the other departments: "Deal with us."



Source: Department of External Affairs, 1983

Old External, though generally biased in favour of multilateralism and the freest possible exchange of capital and trade goods, was often able to stand sufficiently apart from specific interests to act as an impartial moderator or broker between competing departments. In the case of the new External, there are clashes, observable at several levels, that have contributed to departmental disorientation or, just possibly, the beginnings of a new orientation that is as yet far from jelling.

Multiple mandates have saddled the department with an awkward mixture of possession goals and milieu goals.⁴ The inheritors of External's internationalist bent have not, for example, found it easy to digest the Export and Import Permits Act. External hands claim they are subject to the same industry pressures that are experienced by Regional Industrial Expansion and the sector departments, but a domestic constituency for the department is taking time to coalesce. There is some evidence that industry pressure groups do not yet feel they have an ally in External.⁵ The fear that economic objectives might be traded off for political objectives in the new department has, however, not yet been borne out, and in fact Canada's economic self-interest has found some surprisingly ardent defenders in policy debates within the department.

In terms of the new structure, there is a potential clash between the department's five geographic branches (Asia and Pacific, Africa and Middle East, Europe, Latin America and Caribbean, and the United States) and its two functional economic branches (international trade development, and economic and trade policy). Integration was intended to make a country-oriented strategy possible, which was considered especially necessary for dealing with an emerging power such as Japan. This principle was quickly abandoned, however, when the issue of Japanese automobile exports arose. The United States branch, which has its own trade relations division and considerable clout because of the proportion of U.S. trade in Canada's international commerce, has probably been the most successful in integrating political and economic relations.

The suspicion that the department is confused about its newly defined tasks is strengthened by the manner in which officials are reexamining their own careers. Political officers are reportedly pulled toward trade assignments and, conversely, trade bureaucrats are seeking political jobs. This may portend better integration in the long run but, in the near term, it has somewhat bizarre consequences. A number of officials have surprised even colleagues by the degree to which they have immersed themselves in trade to the exclusion of other perspectives, and External's old forte, political analysis, appears to have lost much of its following.

The Department of Finance

The Department of Finance has been accurately described as "the focal point of economic management in Canada"⁶ and "a court of last review

for economic policy.’’⁷ Finance is the custodian of at least some, if not all, of the Canadian government’s highest priority goals, an enormous range of policy instruments and a vast amount of information and expertise. Not only is it endowed with major responsibilities for macroeconomic policy under the Financial Administration Act, but also it can use its general mandate for economic management to intervene in other departments’ activities to ensure that they conform to the government’s overall direction.

In the field of trade policy, Finance has staked a claim which overlaps with that of External Affairs, insofar as the former department sees itself leading on trade-financial links and on the rules governing export finance. Finance is also the major actor on import policy questions. The department is in charge of the customs tariff and all policy matters relating to contingency measures (anti-dumping, countervailing duties legislation and safeguard actions, except for quotas), duty remissions and customs valuations. The Tariff Board and the Canadian Import Tribunal (formerly the Anti-Dumping Tribunal) report through Finance, and the department takes the lead at GATT anti-dumping and subsidies committee hearings. Opinions differ as to whether the department would play a more or less effective role in trade policy without the highly detailed and intensive involvement that its control of the main levers of import policy gives it. Its general mandate for economic management would certainly be enough to keep it in the game, but not as active on a day-to-day basis or in possession of as much legislative authority. Understandably, Finance officials are adamant about retaining their import responsibilities.

It is significant that Finance enjoys a large measure of both *de facto* and *de jure* autonomy. Ministers and officials from other departments simply cannot challenge Finance in a number of areas in which that department possesses virtually all the available knowledge. By law and custom, Finance also acts on its own to a considerable extent. The department is, for example, custodian of the budget process, which gives it an unparalleled instrument for undertaking major initiatives. This device was employed to keep other departments from taking a hand in the development of the National Energy Policy in 1980, despite the impact the policy was sure to have in the fields of foreign affairs and trade.

Finance has such enormous clout that not much can be done in international economic relations without at least its tacit approval. The question is what form its participation will take. In recent times, the department has been more inclined to defend its prerogatives than to exert intellectual leadership in the Ottawa community. Its ingrained habit of acting on its own initiative has not changed since the advent of the many new microeconomic departments which have needed to be pulled together. It took hard battles in the 1960s to get Finance to give advance briefings to the prime minister and Cabinet on the contents of the budget, and similarly hard battles in the 1970s to force Finance to come up with a fiscal framework for the government’s planning.

Finance's international activities have not been given much impetus in recent years. The department was an aggressive player in international trade questions at the beginning of the 1970s but its influence faded thereafter. This was largely due to the individuals in command of the department and those charged with carrying out its international responsibilities. The departure of Simon Reisman, the last deputy minister to cut his teeth on trade issues, and of Rodney Grey to become trade negotiator in Geneva, made way for persons who were either less interested in international matters or less inclined to make their weight felt in the bureaucracy. The evidence is inconclusive as to whether Finance is now once again bent on exploiting its considerable potential influence in the international area.

There are varying perceptions of where Finance stands on the substantive issues of international economic relations, but the department is given credit for having been a liberal force in the Tokyo Round in the 1970s. Insofar as Finance is driven by an imperative for economic efficiency, it is reasonable to place it on the "open" side of the debate. Finance is also, of course, inclined to show its "Treasury Board" face to the other departments, fulfilling its role as the defender of the taxpayer by arguing that the economy will be hurt by too much spending.

The Bank of Canada

The preamble of the Bank of Canada Act states that the Bank's responsibility is to "regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary actions." The act, together with certain other pieces of legislation, so orders the relations between the Bank and private financial institutions, especially the chartered banks, as to enable the Bank to influence the rate of monetary expansion and availability of credit. In addition, in its capacity as fiscal agent for the government, the Bank handles debt management and foreign exchange transactions, including the transactions of the exchange fund account.

There are numerous legislative safeguards of the Bank's independence. To mention a few of the more salient, the government has no voting representatives on its board. The governor and senior deputy governor are appointed for seven-year terms and hold office during good behaviour, not at the pleasure of the government. The Bank's expenditures are not subject to the control of Treasury Board and its staff do not come under the Public Service Commission.⁸

The discussion of exchange rate policy below shows how the Bank's legislative instrument structures the interplay of influence between itself and Finance. The legislation itself is built on the fundamental concept that there is a vitally important distinction between the creation and the expenditure of money. This distinction has been given institutional recognition

in other jurisdictions, however, without resulting in such a degree of central bank autonomy. The Banks of England and France are, for example, much less free of government intervention than the Bank of Canada.⁹

Moreover, the Bank has thrown up numerous bulwarks to add to its legislative protection. Indeed, it has made itself an almost impregnable island in Ottawa. There is a single causeway in the form of continual discussions with the Department of Finance, but its sole other tie to government decision making consists in occasional meetings between the governor and the prime minister, held at the behest of the latter. The Bank is not represented in the Cabinet committee system and its officials manifest considerable distaste for the constraints of interdepartmental coordination and negotiation.

Another telling sign of the Bank's self-imposed isolation is its reliance for information on its own "net," linking central bankers with the Bank of International Settlements (BIS) in Basel. The Bank of Canada is included in the distribution of some embassy communications, and may initiate requests for more, but it could hardly be described as avidly pursuing this avenue. Furthermore, the Bank's hiring policy is to recruit new personnel from graduate school and let them rise thereafter within the organization. Overtures from External Affairs to start a program of personnel exchanges have led nowhere. Though the Bank's alumni are sprinkled throughout the government, particularly in Finance, a corresponding flow of mid-career officials to the Bank is definitely discouraged.

The Bank carefully refrains from trespassing on the territory of the economic departments, evidently believing that it should do unto others as it would have done unto itself. The governor goes no further, indeed, than occasional pronouncements to the effect that monetary policy cannot stand alone and that its impact is heavily dependent on the other policy instruments in the hands of government.

The Bank's recent isolation contrasts with its earlier history when it was more closely integrated in discussion of economic policy in Ottawa. The first governor, Graham Towers, was a frequent participant in formal and informal sessions of senior mandarins. One reason for the Bank's greater involvement in the past was that its research department contained a greater portion of the government's capability for economic policy analysis than it does now, given the proliferation and growth of economic departments since the early 1960s. There was also the indelible imprint left by the Coyne fiasco of 1962, prior to which the then governor had been seeking to extend his turf in all directions, with disastrous results. Mr. Coyne's successor, Louis Rasminsky, determined that the Bank would have to stick rigidly to its legislated mandate in order to reestablish its reputation. Rasminsky's personal stature ensured that he himself would be able to make his weight felt in Ottawa, but his successor, Gerald Bouey, has been disinclined to widen his own involvement, or the horizons of the Bank, beyond the Bank's legislated responsibilities.

The Department of Regional Industrial Expansion (DRIE)

As part of the governmental reorganization of early 1982, this department was established through the amalgamation of the regional programs of the Department of Regional Economic Expansion (DREE) with the industry, small business and tourism components of Industry, Trade and Commerce. DRIE's mandate covers manufacturing, processing and service industries, as well as regional development, tourism and small business, and trade and commerce within Canada.

In its present state, DRIE is essentially a funded-program delivery mechanism. The department is heavily engaged in awarding of subsidies through its industrial and regional development program. Its main links are with industry, and business is more inclined to see an ally in it than in External Affairs. The department's sectoral responsibilities are reflected in its policy orientations. DRIE officials are not out-and-out protectionists, but arguments for temporary relief from foreign imports find a favourable hearing among them, and they place great weight on the human dislocation that would be caused by letting uneconomic plants go out of business.

DRIE advises on the competitiveness of industry with respect to requests for tariff changes or border measures of protection and researches proposals for duty remissions. It could claim a significant role in trade policy on the ground that this should be part and parcel of industrial development policy, and that trade policy experts should be working in tandem with industry specialists. The decentralization of the government during its reorganization did, however, draw many of its sectoral specialists to regional offices throughout Canada, and this has weakened DRIE in the international field. William Teschke, who served as deputy minister from 1983 until his retirement in 1985, resolved to lead the department into the policy process and, at the same time, develop a counterbalancing international dimension to its activities, but he was hampered by a lack of personnel to generate policy goals and thrust.

Judging by personal links rather than by departmental missions, DRIE is far more likely to make common cause with External Affairs than with the sector departments. This is because large segments of both departments were originally together in the old ITC. In recognition of the need to preserve an unbroken chain between export sales and the earliest stages of the production process, there is also a regular personnel exchange between DRIE and External.

Other Actors

All the natural resources come under the purviews of other departments, which are occasional actors in international economic policy making and represent the interests of their domestic constituents therein. Both the sector departments, such as Fisheries and Oceans, and Energy, Mines and

Resources, and other microeconomic departments, such as Communications, are equipped with international directorates or divisions.

Pre-eminent among the sector departments is Agriculture, which has the longest tradition of sustained international involvement. Four or five members of the department are in fact posted in embassies abroad, though the project of an agricultural foreign service has thus far been nipped in the bud. Agriculture's constituency outside government is divided between western agricultural producers seeking to expand markets abroad and eastern farmers endeavouring to protect themselves from imports. Within the department, a more outward-looking approach is taken by its international trade policy division than by the marketing arm of the marketing and economics branch, which administers the Canadian Agricultural Products Standards Act and is more exposed to pressures from protectionist farmers. The influence of the Canadian Cattlemen's Association has increased greatly of late, and is particularly reflected in the government's efforts to get the European Community to reduce its meat export subsidy.

Two other actors deserve brief mention. Consumer and Corporate Affairs weighs in on the side of freer trade and lower prices for the consumer, but its influence is small and, in general, the department is considered to possess insufficient expertise to be a significant force. Its main allies outside government are the Consumers' Association of Canada and the Canadian Importers Association.

Secondly, the Canadian International Development Agency (CIDA) has the right of consultation with respect to the overlap between development issues and international economic relations. After the call for a New International Economic Order by the developing countries, CIDA strove for a voice in interdepartmental discussion of trade issues, and through the 1970s the agency was represented on the interdepartmental committees on low-cost imports and on the generalized system of preferences, where it was a consistent opponent of trade restrictions and an advocate of special provisions for the poorer developing countries. In recent years, CIDA's importance in international economic policy making, never very great, has receded.

Territory and Policy

The next two sections examine the influence of bureaucratic politics on the substance of policy. Though often muted and forced underground during sustained periods of cooperation, there are, in fact, two contests going on at one time, one over policy and one over where the responsibility for policy is to reside. There are also, potentially at least, two games: the first between departments, and the second between the public service and its elected masters. The two games can overlap, and the balance of forces in one can affect the balance of forces in the other. In particular, the extent of politicization of the three issue areas being examined here varies consid-

erably, and it is important to determine the difference that politicization makes to the relative weights carried by bureaucratic players, and to the policies that emerge from their efforts.

International Trade Policy

The process of formulating trade policy is diffuse, and a substantial portion of day-to-day trade policy making is carried on outside the interdepartmental process. This is true of much of Finance's handling of import policy questions. Amendments to the customs tariff, in particular, are introduced in a ways-and-means motion that accompanies the budget statement and, while the other departments make representations beforehand (and External is supposed to have "substantial involvement with Finance in tariff issues"),¹⁰ they are not involved in drafting the motion. The only way they can get involved is through an international negotiation, which gives External and DRIE the right to participate in hammering out tariff offers and assessing the benefits to be received in return.

The manner in which bureaucratic influence is wielded here should be viewed against the backdrop of the remarkable cohesion that characterized the trade community in earlier times. The well-known trade mandarins, among them Robertson, Wilgress, Bryce, Reisman, Ritchie and Warren, were, each in his own generation, members of a fairly close group in which individual capacity mattered much more than departmental affiliation. There was much mutual respect and a belief that the interdepartmental system worked and that a good deal should be done to make it continue to work.

This sense of collegiality was rooted in a conviction that national economic policy should be made to conform to Canada's international obligations. The deputy ministers of the three major departments, Finance, External Affairs, and Trade and Commerce (after 1969, Industry, Trade and Commerce) all had trade experience. The postwar principles of liberalization, multilateralism, and adherence to the GATT served as a bond uniting the trade community and imparted thrust and direction to their efforts. A "trade policy view" took hold. It did not advocate the unilateral dropping of tariff barriers but, insofar as it transcended the interests of specific sectors and treated tariffs as negotiable in return for improved access, it aimed at continuing liberalization.

The spirit of cooperativeness has persisted, with decreasing but sufficient force to overcome departmental divisions and, at least until recently, to preserve a degree of initiative on trade matters for the senior bureaucrats. Indeed, protectionist ministers have in the past found it frustrating that their point of view was not getting a proper hearing from officials. The balance of forces was certainly tilted toward liberalization. Prior to the reorganization in 1982, the basic division on trade policy was between the

sector departments and the industry branches of Industry, Trade and Commerce on the one hand, and the trade officers in the same department, very loosely allied with Finance and External Affairs, on the other.¹¹ The latter group had the upper hand, and each of the main actors was in a position to bring a clear and distinct perspective to the discussion: External Affairs placed trade in the context of political relations; Finance emphasized the management of the economy; and the trade officials focussed on the terms and conditions of access to markets, maintaining access and improving it. This made for worthwhile debate and an easily understandable presentation of the issues to ministers.

As a legacy of the attitudes and practices that were instilled in bureaucrats in the 1940s, 1950s and 1960s, trade policy making continues to be characterized by cooperative problem solving rather than by conflictual bargaining. When asked about their problems in pushing an item through the system, trade bureaucrats are more apt to talk about procedural difficulties than about differences of opinion with other bureaucrats. Indeed, many are inclined to see benefit in different perspectives being brought to bear on an issue. They appear to value a creative tension, which is a sign that they can see beyond their own departmental interests.

For example, if export financing for a deeply indebted country were under discussion, Finance might take the role of banker and External might advocate making exceptions for major trading partners or for countries which have just received export credits from the United States, but each department would exhibit an understanding of the other's position. If an agreement could not be reached among officials, the matter would be submitted to Cabinet without, it appears, too much hesitation. Thorny issues that are not in a form suitable for cabinet decision are resolved not so much through bargaining sessions as by gradual persuasion, grudging agreements to go along, or the decision of disaffected participants to dissociate themselves from the issue altogether. Whatever the case, it is more likely that the losers will accept the outcome than that they will immediately set about reversing it.

Even in the case of dealings between External Affairs and Agriculture, there are good communications and no indication that one department is consistently trying to steal a march on the other. The efforts of participants are directed more to honing arguments than to hatching strategems. Trade policy debate between the two departments revolves around such detailed questions as the representative period required by the GATT to prove injury from imports before quotas can be imposed. When an issue is decided upon, the unspoken assumption is that the decision would not be altered if it were appealed to a higher level. The exception to this rule consists in the periodic use of delaying tactics. In response to complaints of injury from Canadian producers, for example, External will stress the need for extensive consultation with the exporting country, in the evident hope that the problem will go away of its own accord.

External Affairs is bound to find a tough competitor in Agriculture Canada, which can muster a squad of officials with long experience (the director of the international trade policy division has been in the field for 28 years) and, even more important, call on a constituency with enormous political clout. The range of arguments that can be employed by External is, however, wider because of the GATT requirement that import quotas be applied on a most-favoured-nation basis. This often increases the number of country divisions or desks in the game and, on an issue such as the recent oversupply of Irish beef, ensures that the considerable weight of the department's United States branch will be a factor. The kinds of arguments that country desks find most effective can be illustrated by a battle with Agriculture over its plan to reduce imports of canned mushrooms from China. External won the battle by arguing that Canada's trade balance with China was too favourable to permit such restraints, and by raising the example of the United States which had restricted textile imports from China, thereby prompting that country to go elsewhere for its soya and corn.

The Decline of the Trade Policy Community

The uncertain trumpet sounded by the government in its recent trade policy decisions has, however, given rise to dissatisfaction in the trade policy community, one manifestation of which is the complaint that nobody is really leading on trade issues. What is certainly evident is that, though a residue of cooperativeness remains, a coherent trade policy view has been lost.

For example, there has been a succession of government decisions with regard to the adjustment problems of the textile and footwear industries that are not easy to square with the idea that Canada remains in favour of trade liberalization. The reorganization of External Affairs, which is formally accorded the lead in trade policy making, has left that department both a stronger player and a player taking a uniform and consistent approach to trade problems, despite having two successive deputy ministers strongly predisposed to an open economy. In the case of the recent extension of footwear quotas, it was Finance which took the side of the consumer in the arguments with officials from the special trade relations bureau of External Affairs, concerning the length of time of the extension and the restructuring and modernization to be required from the protected industries.

One explanation of the protectionist slant of such trade decisions is that recent policy positions on industrial adjustment have been developed by officials with sectoral responsibilities, and trade policy positions have been drawn up by officials responsible for administering quotas. Neither of these groups could be expected to go against the thrust of their continuing responsibilities.¹² This explanation is plausible, because it is generally true

that the drafter controls the agenda and his paper becomes the focus of interdepartmental debate.

Another explanation of why protectionist tendencies have become more apparent in Canada is that certain aspects of trade policy making have become highly political. The results of trade negotiations, for example, are relatively predictable, their regional impacts can be assessed easily, and a minister with an acute political sense is in a good position to determine their electoral effects. The same is true of special import protection. The domestic political advantages of protection are stark and obvious, and it is easier to act in a politically expedient manner than to defend a policy that would serve the wider public interest. Within the Cabinet, log-rolling displaces policy preference in determining ministers' positions when their colleagues have substantial interests to protect. Finance Minister Lalonde, for example, though instinctively inclined toward free trade, often took the side of his Quebec colleagues against the views expressed by his own department.

In such circumstances, a deal to prolong temporary protection, once struck at a lower level of the bureaucracy, is exceedingly difficult to overturn, not just because it means going back to the other departments but also because the original agreement probably reflects officials' estimation of where the weight of Cabinet opinion comes down on the issue. What counts is how the policy views of bureaucrats mesh with the political interests of their ministers. Some officials have sought to accommodate the increasing militancy of ministers by shifting their views toward an acceptance of temporary protection provided that it is accompanied by rationalization measures.¹³ Another response has been to go with the protectionist tide but endeavour to salvage something for the cause of free trade. The need to fashion a set of options for ministers in such a manner that even the most protectionist option includes an element of liberalization has become an important tactical consideration for officials.¹⁴ Those who have sought to turn the debate around with warnings about Canada's GATT obligations have, however, customarily evoked exasperation and scorn from their political superiors.¹⁵ Indeed, over the years of the Liberal government there has grown a divide between ministers and senior trade policy officials.

Just at the time when it needs all its resources to rebuff the encroachments of ministers, the trade policy community has undergone a form of intellectual disarmament. This has come about in two ways. In the first place, many bureaucrats point to the Cabinet committees and ministries of state instituted under Prime Minister Trudeau for the purpose of bolstering ministerial control and enabling better coordination of government activities. Critics of these procedural reforms contend that the revamped organization has proved so cumbersome that arguments have been internalized by their originators and positions rigidified before other departments have even been made aware of them. The Cabinet committee structure is accused of placing too much emphasis on process at the expense of substance and

involving too many players to make possible serious, expert discussion resulting in consensus.

Moreover, a side effect of the reforms was the abolition of interdepartmental committees standing outside the Cabinet committee structure. This move was predicated on the idea that, as the Cabinet would take the ultimate decisions, everything should be funnelled up to it. A prominent casualty was the interdepartmental committee on commercial policy, a body whose significance had waxed and waned but which had enabled officials from different departments to have thoroughgoing discussions even before the first draft of a paper was introduced.

Secondly, the ideology of trade policy making has been badly battered in recent years. The Tokyo Round signalled the advent of a new doctrine in Canada and elsewhere that trade policy should be based on an assessment of industrial interests and that policy positions should be judged not primarily in terms of export gains but in terms of total impact on a sector. The criteria used to assess benefit and loss in the next set of trade negotiations will probably place central importance on where new investment is to take place. Though Canadian officials outside Ottawa's trade community still believe it to be a tightly knit group of adherents to the religion of free trade, the religion has lost much of its unifying grip, notwithstanding the resurgence of interest in removing trade barriers between Canada and the United States.

Today an effort is being made to recover a trade policy view by setting up a commercial policy forum involving the key players. In 1983 a trade policy committee including representatives from Finance, DRIE, Agriculture and other departments, depending on the subject under review, was established under the chairmanship of the assistant deputy minister for economic and trade policy in External Affairs. Though against the rules, this innovation was allowed to proceed by the Privy Council Office. There is pressure to go further, partly motivated by departmental self-interest. Finance and DRIE, in particular, would like to be cut into trade policy making at an earlier stage. What must appeal to trade bureaucrats even more, however, is the potential for a coherent, shared perspective on trade issues as an instrument for beating back the assaults of ministers responding to pressures from special interests.

Trade and Industrial Policy

Superimposed on the question of how to engender and incubate the most fruitful discussion of trade policy is a continuing argument about how the machinery of trade policy making is to be designed. Defenders of the new status quo, of course, argue the importance of integrating economic with political objectives in Canada's dealings abroad. Others, bemoaning the loss of clarity and comprehensiveness in the way the government addresses trade issues, advocate a single ministry, partly modelled on the

office of the United States Special Trade Representative but integrating responsibility for getting and maintaining access to external markets along with the control of import policy instruments. The counter argument is that such a department would be too small and, shorn of its links to the mandates of the great departments of state, would lack clout in the Ottawa community. A third group of would-be reformers, reflecting the shift of focus that has overtaken trade policy, contend that trade policy proposals cannot be formulated in isolation from industrial development policy, which necessitates a reintegration of functions in a department akin to Industry, Trade and Commerce as it was between 1969 and 1982.¹⁶

The organizational question sharpens present and potential territorial battles. Such battles are endemic in the lines which must be drawn back from trade policy through marketing, production, finance, research and development and every other stage of the industrial and commercial process. A trade negotiator speaks with more authority the more direct his links with industry. Agriculture, for example, will always contest External's trade mandate on the basis of the closer ties that the former department enjoys with the agricultural producer.

There is, moreover, the makings of a major territorial struggle between External Affairs and DRIE. In the perspective of the latter department, External's negotiators have been, in fact, shaping domestic policy through their handling of trade relations. As DRIE prepares its forces to play a more active role in trade policy making, it is seeking to bring home to other departments the lesson that it has the capacity to torpedo major economic policy initiatives because of its links with industry.

External Affairs and DRIE are warily watching each other's moves to develop parallel resources in the areas in which they overlap. External already has some sector experts, several of whom were hired away from DRIE and the latter department appears to be on the verge of acquiring a trade policy component. Both sides agree that a distinction should be drawn between sector expertise per se and competence in the trade policy aspects of a sector. The people who do sectoral analyses are not usually good at feeding these into trade policy. This argument can, however, cut both ways. So can the argument that a bureaucrat has to be equipped to talk the same language as his opposite number, to be able to tell when the wool is being pulled over his eyes. At the root of the problem of duplication of departmental resources is the inability of a policy maker to feel confident of the backup he is receiving from another department which is perceived to be going in a radically different direction.

If the machinery were working as contemplated in the reorganization, External should be able to rely on DRIE and the other sector departments for analyses on which to base its positions in trade negotiations. Notwithstanding the government's intention, External initially promoted sectoral free-trade discussions with the United States with little, if any, coordination with DRIE. There was no thorough analysis of the competitiveness of

Canadian business in the relevant sectors, nor any effort to elicit the views of businessmen. Now that this initiative has been folded into a much more comprehensive trade policy exercise, DRIE is under pressure to produce analyses of sector competitiveness. In the words of one DRIE bureaucrat, “We are doing them to keep External from doing them.” The run-up to the next round of multilateral trade negotiations is, in fact, providing the first major test of the shaky relationship between the two departments.

International Macroeconomic Policy

In the area of international macroeconomic policy there are two actors at centre stage, Finance and the Bank of Canada, and a third, External Affairs, straining to come on from the wings.

In contrast to international trade, the making of international macroeconomic policy is not shot through with domestic politics. The subject matter is sufficiently esoteric, and the impact of policy on the individual citizen is sufficiently indirect, to discourage the sustained involvement of domestic constituencies and to keep ministers at bay. This does not mean that, on occasion, ministerial influence cannot be decisive. Nor does it mean that there are not other, particularly international, influences that shape policy. Bureaucrats are, however, clearly a more important factor in this area of policy making than are ministers.

In this area more than any other, the control of policy turns on which actor represents Canada in the governing bodies of certain international organizations and at international meetings. On the one hand, the minister of Finance being Canadian governor of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD or World Bank), Finance leads the delegations to the annual meetings of both bodies and that of the IMF interim committee, and the Bank of Canada's participation is peripheral.¹⁷ Similarly, Finance manages the Canadian input into the OECD's economic policy committee and its important Working Party Three (WP3). The Bank of Canada is represented, but its contributions to these meetings normally receive prior clearance from Finance. On the other hand, the governor of the Bank is the sole representative to the frequent meetings of central bankers which are held under the auspices of the BIS in Basel.

External Affairs has been striving to maintain and expand its stake in this area of policy making. This thrust was evident throughout the 1970s as various individuals with economics backgrounds, some recruited from elsewhere in the government, were positioned so as to make them possible conduits to the Bank and Finance. More recently, an effort was made in External's general economic relations division to develop specialists in monetary and international macroeconomic trends, an effort that was pushed along by External Affairs Minister MacEachen, who had come from the Finance portfolio and considered this a priority.

It is clear that External cannot be excluded completely from international macroeconomic policy because of its traditional mandate for the conduct of foreign relations. To take one example, debt issues are certainly of central relevance to Canada's relations with the developing countries. If Jamaica were to perceive that Cuba was getting a better deal in Paris Club debt rescheduling negotiations, the need to keep the interests of a Commonwealth partner to the fore would give External a legitimate basis for intervening in the issue. External's general mandate is, however, a weak reed on which to lean if sustained and intensive involvement is the objective.

A source of surer leverage is the department's newly acquired trade responsibility. It is understandable that External is, of all government actors, the most eager to argue against the compartmentalization of debt, trade, export finance and macroeconomic policy issues. The battle to get policy interdependence recognized as a basis for redesigning the control of policy is waged abroad as well as at home. External has the mandate for the GATT, and its minister and deputy minister of Trade attend the Quadrilateral meetings in company with their counterparts from the United States, Japan and the European Community. The deputy minister can also be expected to be an enthusiastic proponent of the informal meetings of trade ministers and senior officials representing Quadrilateral countries and some newly industrializing countries, which took place in 1984 in Washington, D.C., and Rio de Janeiro. This device was deliberately intended to link protection and debt issues, and thereby get a dangerously stalled process of tackling these issues moving again. Should the significance of these gatherings grow, it is not difficult to see the opportunity that exists for External Affairs to strengthen its shaky purchase on international economic policy through coordination of the Canadian input.

As this example suggests, there is a symbiotic relationship between the prestige and importance of international groupings and the clout possessed by the domestic actors who represent Canada in these groupings. The latter have an interest in infusing energy and significance into the international meetings they customarily attend. As such gatherings make few decisions, their impact is assessed chiefly in terms of the intelligence they provide and the level of representation they attract. In the case of meetings perceived to be of importance, senior players turn up at the sessions of interdepartmental task forces convened to organize the Canadian input, and influence accrues to the department that is shaping the terms of the discussion and that will lead the delegation abroad.

The Summit process provides a forum in Ottawa for discussion of the nexus combining debt, trade and macroeconomic issues, and automatically draws in a wider range of participants than just the Bank of Canada and Finance, as well as lofting External Affairs into a coordinating role. An impending meeting of heads of government affords the lead department an opportunity to hector other departments into making decisions they would prefer to avoid taking or to postpone altogether. External Affairs

is bent on seizing the opportunity the Summit affords to coordinate policy both internationally and domestically.

The importance of the Summit in intra-governmental jockeying is perhaps best illustrated by the pre-emptive tactics employed by Finance to assert its own control. At the time of preparations for the Versailles meeting of heads of government in 1982, for example, Finance feared that External Affairs might be prompting the prime minister to propose a more comprehensive attack on Third World debt problems than the conservative approach favoured by the department. The deputy minister of Finance convened a series of lunch meetings, the guest list including all three External deputies. Midway through the series, Finance distributed a paper prepared by its international finance division. By thus taking the initiative, Finance believed that it had reined in any inclination to advocate a radical solution to the debt issue at Versailles.

The degree of External's penetration into the realm of international macroeconomic policy has been exceedingly modest. Finance has never proved sufficiently receptive to External's overtures to enable strong and dependable lines of communication to be established. The Bank has given ground hardly at all. Its senior deputy governor has occasionally attended meetings convened by External, and its governor has come to some of the informal dinners given by the deputy minister of Trade. Thus far, such meetings have failed to engage the Bank in the kind of far-reaching discussions External Affairs would like to see.

Abroad, External has now gained representation on delegations to IMF meetings and to the OECD's WP3 but, in the case of the latter, only when trade and export credits are under discussion. This departure from tradition, in particular, occasions reactions in the Bank and Finance ranging from amusement to muttered warnings that, if External Affairs were to take too prominent a role in the sessions of WP3, central bankers would simply refuse to reveal sensitive information on exchange rate issues, for example, and would funnel such information exclusively into their own meetings in Basel. Such a reaction reflects not just a Canadian predilection, but the fact that central bankers and treasury officials generally are leery of having sensitive information fed into the diplomatic network. By the same token, there has been only limited progress in the sharing of intelligence. External now receives IMF documents from Finance but is still barred by the Bank of Canada from the secret documents of the BIS.

In the international macroeconomic field, interdepartmental jockeying for position is motivated to a considerable extent by the chance of getting a better purchase on domestic economic policies. There is not much real policy content in the field. Canada often can do no better than adjust to a set of circumstances over which it has little control. There is, for example, no Canadian policy to speak of regarding macroeconomic coordination, the importance of which was highlighted at Versailles and given even greater emphasis in the Williamsburg Declaration in 1983. A major part of the

reason is Canada's exclusion from continuing great-power discussions. One of the decisions taken at Versailles was to make the Group of Five (G-5) Finance ministers (those of Britain, France, Germany, Japan and the United States), meeting twice a year with the managing director of the IMF, the major instrument for coordination. At Williamsburg the range of policies to be kept under review by the G-5 was considerably widened. Should this particular gap in Canada's international macroeconomic policy be filled, it would help to legitimize External's involvement at the centre of domestic policy, because the department would serve as the conduit linking Ottawa with a possibly expanded G-5. Depending on how the mechanism of international coordination were to develop, External also could acquire a degree of leverage over economic policies, even including structural policies related to employment and productivity.

Exchange Rate Policy

The characteristics that cast into relief the contrast between international macroeconomic and international trade policy are even more pronounced in the case of exchange rate policy formation, and push it to the sidelines of both the major bureaucratic games. This does not mean that exchange rate policy determination is exempt from bureaucratic politics. The effort to keep it out of both interdepartmental and political arenas does, after all, demand bureaucratic skill and influence.

Exchange rate policy is the sole province of two actors, Finance and the Bank of Canada. The interplay of influence between them is almost impossible to discern in detail, partly because the parties can argue legitimately that making the process too transparent could lead to participants in financial markets taking actions in anticipation of policy that would have the effect of controverting that policy. Each is, moreover, inclined to use the opacity of the process to nudge responsibility for the policy outcome a little bit in the direction of the other.

Since the decision to float the dollar in 1970, Canadian authorities have had one declared policy, that of letting market forces determine the exchange rate while standing ready to smooth transitions from one level to another. There are close and continual consultations between the Bank of Canada and Finance over the timing and degree of intervention in the exchange market, but the precise manner in which such decisions are taken, or which party has the final say, remains a murky area. The Bank handles the transactions of the exchange fund account, Canada's holding of international reserves, in its capacity as fiscal agent of the government. On the surface, this would appear to mean that the Bank takes its orders from Finance. Finance must indeed take the ultimate responsibility and could tell the Bank that it is intervening too much or not enough, which would have the effect of an instruction. At the same time, it is highly likely that receipt of such an instruction would in itself trigger a crisis, calling for a meeting

of senior officials of the Bank and Finance with the minister to iron matters out. It can be safely surmised that Finance would be loath to precipitate such a development because of the complexities and sensitivities of the exchange market and the superior claim of the Bank to a grasp of the market's technicalities.

In a wider sense than that of intervention policy, exchange rate policy is part and parcel of the Bank's conduct of monetary policy.¹⁸ The Bank appears to go beyond its declared policy to aim at keeping the rate within a band that is periodically adjusted. Whereas Finance's bureaucrats deal with the Bank's officials from a position of ultimate authority in discussions of intervention policy, their leverage with respect to monetary policy is wholly circumscribed by the relationship between the minister and the governor. Legislation, combined with the exigencies of practical politics, has structured this relationship so as to give the Bank remarkably free rein.

The Bank of Canada Act requires the minister and the governor to "consult regularly on monetary policy and on its relation to general economic policy." Furthermore, according to a formula that was worked out between Governor Rasminsky and the government in 1962 and later enshrined in the Act:

If . . . there should emerge a difference of opinion between the Minister and the Bank concerning the monetary policy to be followed, the Minister may after consultation with the Governor and with the approval of the Governor in Council, give to the Governor a written directive concerning monetary policy, in specific terms and applicable for a specific period, and the Bank shall comply with such directive.¹⁹

The Bank defends this formula with the argument that the minister's instruction will not upset financial markets because the markets will recognize what the governor has been doing is wrong-headed and will approve the minister's action. The main advantage that the Bank sees in the formula is that it enforces a sharing of responsibility for monetary policy. Governor Bouey has said, "The Bank must take full responsibility for monetary policy so long as no directive is issued, and the government must take full responsibility because there is a power to issue a directive."²⁰

Of course, there is room for the minister to influence the governor by means far short of such a directive and there are known instances of the minister asking for a delay in raising the bank rate, or for a reduction in the amount of the intended rise, and the governor complying with his request. Nevertheless, for practical purposes the Rasminsky formula affords the Bank a substantial degree of autonomy. If, for example, the minister of Finance were tempted to say in the House of Commons that he disagreed with the Bank's policies, he could anticipate the Opposition would reply, "Why don't you send the governor an instruction?" To be sure, if the governor were behaving in a bizarre fashion, such an instruction would

be well understood by the financial community. In a more ambiguous situation, however, the governor's almost certain resignation and the ensuing disarray of the markets could have exceedingly unfortunate repercussions for the minister of Finance, enough to dissuade him from taking action in the first place.

Though the foregoing describes the parameters which govern the exchange rate policy process, the hard edges are smoothed and the interplay of influence is made fuzzier, by the close and continual interchange between Finance and the Bank. The formal channel of communication is provided by the attendance of the associate deputy minister of Finance at weekly meetings of the Bank's executive committee and of the deputy minister at the Bank's board meetings every six weeks or so. Both meetings are really held for purposes of policy review, not policy making, but they are supplemented by numerous informal contacts at various levels. There is continual discussion of exchange rate movements and forecasts between the Bank and Finance, and occasional differences do arise. It is significant that the participants do not explain the differences in terms of entrenched institutional interests, prejudices or viewpoints, but rather in terms of conceptual problems or problems occasioned by the unavailability of data at sufficiently frequent intervals. Disagreements are seen as providing an opportunity for mutual exploration of concepts, with the effect of giving both sides a better "feel" for the subject.

The recent move of the balance of payments section of the international finance division of the Finance department into a new division concerned with monetary policy and balance of payments does suggest that the department is attempting to bolster its capability in this area. Nevertheless, Finance department personnel do not exhibit, to any significant degree, the feeling that the Bank is running roughshod over them. Indeed, it is fair to say that whereas there can be day-to-day disagreements between the Bank and Finance, there is no sign of a fundamental difference of view between the two. The exercise of bureaucratic influence is conditioned by the high value they place on their mutual cohesion. The links that bind them, composed of their professional backgrounds and outlooks, their frequent working contacts, and the incentive for Finance to get along with the Bank provided by the Rasminsky formula, make any major divergence extremely unlikely.

Since the Bank stands apart from the interdepartmental process generally, other departments can only interact with it through Finance. There is no evidence that these departments make a serious and sustained effort to involve themselves in exchange rate policy, but if they were to want to do so the priorities and planning committee of Cabinet provides the only forum in which this could even be attempted. An interchange on this subject could not be expected to take place at the level of officials. This means that no viewpoint differing from the prevailing orthodoxy of Finance and the Bank, for example, that exchange rates should be manipulated down

for trade purposes, is represented in the policy process. The duumvirate of the Bank and Finance goes virtually unchallenged.

The insulation of the exchange rate policy process from the pulling and hauling of interdepartmental politics means that the ideological orientation of the Bank of Canada is a primary determinant of policy. The first principle of this ideology is an emphasis on price stability. In Governor Bouey's words, "A commitment to maintaining the value of money must be at the root of monetary policy."²¹ This has led the Bank to try to fend off pressure for a lower Canadian dollar which, it is held, would raise the cost of imports and create a substantial risk of prices shooting upward. The governor has been at pains to show how the inflationary effects of exchange rate depreciation would be felt sooner, and would cut more deeply, than any benefits to trade.

Under pressure from market forces and from political leaders seeking to stimulate the economy, the Bank eventually has to give ground, but it tries to do so as gradually as possible to avoid the appearance of a sudden departure from current policy or a loosening grip. An advocate of a major policy shift is going to have to contend with the Bank's formidable argument that the reaction of exchange markets to even a hint of change will bring disaster, with the strong implication that matters should be left in the hands of central bankers, who understand the mysteries of the markets.

How the Games Overlap

The two major games played in Ottawa pit bureaucrats against their ministers, and departments against each other. Comparing the three policy areas discussed above, it appears that politicization has the effect of immobilizing officials who do not share the orientation of their political masters and who cannot, therefore, exert great weight in interdepartmental discussions. Where politicization is slight, as in international macroeconomic policy, or can be successfully contained, as in the case of exchange rate policy, senior officials are the major players and can make their departments fall into line behind them.

Another contrast is between the restrained competition that characterizes international trade policy making and the close, secretive cooperation between Finance and the Bank of Canada. These two appear to have decided that their family quarrels are best preserved from public view, for fear that other would-be participants may be afforded an excuse to step in. This means that, in the last analysis, each defers to the other in its respective area, and both are leery of getting involved with outside departments in exchanges of information or views that might propel them into the arena of interdepartmental pulling and hauling. That could, in turn, provide outside interests with more points of contact whereby to press for policy changes and could give more ministers an opportunity and incentive to

cater to those interests, thus enabling the intrusion of political influences and loosening the grip of officials.

Territory and Policy Coordination

We have observed that it was the government's intention that the various strands of foreign economic policy should be drawn together to enable a coherent response to the "crunching integration" of the 1980s and 1990s. What strikes the eye at once is that by its handling of the reorganization of 1982, the government has permitted the prospects for policy coordination to become tightly bound up with the territorial ambitions of External Affairs. These ambitions are, indeed, the other side of the coin from External's mandate to plan all of Canada's foreign relations. To be sure, External professes no ambition to influence exchange rates. In the other policy areas examined here, however, the department can be seen to be fighting a war on two fronts: at the interface between trade and industrial policy, and at the interface between trade and international macroeconomic policy.

As a part of the reorganization, the department sought to equip itself for fulfilling its mandate by establishing the position of coordinator of international economic relations, reporting to the Secretary of State for External Affairs (SSEA). The coordinator's job was to be combined with that of deputy minister, International Trade (who, in the latter capacity, was to report to the minister for International Trade) but the Department of External Affairs Act did not require that this should always be the case. The new role was inspired by an earlier successful innovation, that of the position of Canadian coordinator of the trade negotiations in the Tokyo Round, which was perceived to have broken a logjam in governmental decision making as well as to have provided an effective means of handling the pressures emanating from provincial governments and private interests. The title suggested an extraordinarily ambitious assignment, reaching far into domestic policy areas and putting the reins on a number of departments. Deprived of the deadlines imposed by a multilateral negotiation, however, and given the unresponsiveness of bureaucrats to instructions issuing from unfamiliar quarters, a coordinator, to be worthy of the title, would have had to have powerful instruments of influence: legislative authority, a clear and detailed mandate, a strong and capable staff, and preferably all three.

That such instruments were denied the coordinator is a sign that the new role did not sit well with the Department of Finance. The legislation reorganizing External Affairs did not define what the coordinator was supposed to do, beyond possessing "such powers, duties and functions as a deputy of the Minister and otherwise as the Minister may specify."²² Insofar as the conduct of international trade and commerce and international development were specifically included in the SSEA's functions and no

mention was made of international financial relations, we might infer that the coordinator's responsibilities were limited to the former.²³ This is by no means certain, however, and it is evident that the prime minister's letters to the two successive incumbents of the position did nothing to make the situation clearer. In consequence, they were in a quandary as to what was expected of them and, at the same time, discovered that their authority extended no further than being able to pull an interdepartmental meeting together. Not surprisingly, therefore, when deputy ministers were shuffled at the beginning of 1985, the position of coordinator was left unfilled.

It is nonetheless instructive to examine how the most recent coordinator (and deputy minister for Trade), Sylvia Ostry, tried to carry out her shaky mandate. She continued the effort to build the expertise of External Affairs by developing cadres of specialists in the department's economic policy bureau and its policy development bureau. This had to be done gingerly because Finance was always ready to argue that the development of a capability for economic analysis in External Affairs would be a misallocation of resources. A strenuous attempt was, however, made by the coordinator to tap research done elsewhere, in the OECD or in the banking community and, by making use of academic and governmental contacts, to stimulate relevant work in a number of private research organizations.

The coordinator also worked toward a justification for extending External's reach a little further into the economic policy domain by laying claim to an issue. As Professor Douglas Hartle has written, "Capturing an interest in a problem is at least as important as finding a resolution to it, because influence, budgets and staff often follow the allocation of responsibility for dealing with a problem."²⁴ This can be attempted by developing a compelling theme to draw departments into an intensive discussion and to justify taking the lead in coordinating interdepartmental activity.

In this case, the coordinator's strategy was to initiate an interdepartmental exercise on the theme of structural adjustment. The underlying rationale was that the shift of comparative advantage in the world made this an urgent issue. Moreover, this issue of structural adjustment offered a means of linking international pressures with domestic industrial development policy, regional policy and employment policy. It provided, therefore, a good basis for integrated work involving External, Finance and DRIE. The coordinator called a number of interdepartmental meetings on the subject and, early in 1984, sought to strengthen her position by placing the issue before the prime minister for submission to the London Summit. The response of the Summit participants was tepid and, in Ottawa, though progress was made at the working level, senior officials in other departments showed little enthusiasm.

A New Orientation for External Affairs

Whether or not External Affairs can coordinate policy successfully, it needs to develop an underlying framework of thinking that would accord with

its basic tasks and serve to support its territorial ambitions. At the base of such a framework would be the premise that Canada confronts grave perils in the manner in which the international division of economic activity is being transformed, a situation worsened by the domestication of the international policy of its predominant trading partner, the United States. Canada is more vulnerable because Canadian microeconomic policy has overemphasized the pursuit of equity and Finance has largely abdicated the role of monitoring the viability of the economic structure. The government has been allowed to indulge the short-sighted designs of politicians and special interests through subsidies, tariff and quota protection, and other ill-considered favours.

In this circumstance, the remedy for a small open economy being hit by a structural shift in the terms of trade would be the internationalization of domestic policy. To take just one example of how a tighter discipline could be applied to this end, an advocate of liberalization would actually welcome the opportunity to argue that a good customer such as Italy would retaliate against Canadian exports of newsprint if Canada were to continue to protect its footwear manufacturers. The single most potent force that could be called upon to counter the demands of domestic interests, and to defeat the arguments of their bureaucratic allies, would be the international force.

If External Affairs were to establish a consistent position in interdepartmental debate, it could seek to impose a new international discipline on Canada's economic policies. Intellectual leadership and technical expertise would enable it to apply this discipline. International organizations, particularly the GATT and the OECD, would be mobilized to act as external monitors of Canadian performance. The management of a wide range of policy levers would be geared to economic efficiency and, most important, the intellectual thrust coming from External Affairs would be sufficiently powerful to defeat parochial designs for special treatment emanating from the political realm.

Without stronger instruments of influence, it is, however, hard to imagine External Affairs achieving such a firm purchase on what would be, after all, some of the government's most important decisions. At the moment, it cannot even be said that the department is united behind, and working toward, the enforcement of an international discipline as its long-term objective. Such a stance would nonetheless command significant support within the department and would permit External to articulate coherently its newly broadened international mission and responsibilities.

Territorial Invasions: Three Case Studies

Three territorial invasions illustrate the impact of the bureaucratic game on the substance of policy.²⁵ One case study exemplifying the importance

placed on representation at international meetings is provided by the recent quarrel over the governorships of the international lending institutions. A second example focusses on Finance's traditional prerogatives and partial autonomy, which enable a policy to be formulated in isolation from inter-departmental politics, at least up to a point where such isolation becomes untenable. In sharp contrast is DRIE's pursuit of its objectives, undertaken in a situation of overlapping departmental responsibilities, where to defend turf successfully often necessitates taking the offensive.

CIDA as Aggressor: The Regional Bank Governorships

This territorial dispute was rooted in differences of opinion over the division of aid funds between bilateral and multilateral purposes. Not surprisingly, CIDA (formerly allied with Industry, Trade and Commerce and now presumably with the trade bureaucrats in External) is a strong partisan of bilateral programs. The agency's major adversary is Finance. Through its international programs division, Finance attempts to exercise a degree of surveillance over CIDA's activities, but the thinking of the department is that interdepartmental involvement in development assistance is at too general a level and the agency enjoys too much autonomy. Differences with CIDA came to a head at the time of the Clark government when CIDA's budget had to be trimmed and it was decided to take the entire cut out of the agency's bilateral funds. Considerable ill will was thereby created in CIDA because it appeared that Finance was favouring the multilateral institutions with which it was, of course, closely associated.

The resulting bitterness spilled over to what became a running battle concerning which organization would provide the leader for Canadian delegations to the World Bank and World Bank Group meetings, and to the meetings of the regional development banks. On the one hand, CIDA was suspicious that its views were being filtered by Finance before reaching the minister of Finance, who was governor of the banks. The agency argued that because the work of these institutions is international development, CIDA should play the primary role and, by extension, the Secretary of State for External Affairs should be the Canadian governor in each case. On the other hand, Finance officials were concerned about exposing their minister to an uncontrolled and independent source of advice. They contended that Finance should retain the governorships because these institutions need to raise considerable sums of money on financial markets. The terms they can offer the developing countries are, after all, going to be determined by the charges they have to pay their own creditors.

Early in 1983, the arrival of new personalities, free of the baggage of past quarrelling, made it easier for Finance to give some ground while retaining the leverage it thought it ought to have. An agreement was struck

whereby the minister of Finance was to remain governor of the World Bank with the External Affairs minister assuming the governorships of the regional banks. There was a “saw-off” whereby Finance’s right of participation in the interdepartmental group drawing up instructions to the executive directors of the development banks was reaffirmed, and CIDA retained a role in the activities of the IBRD.

Once it had been put to ministers, however, the deal foundered because of the refusal of Finance Minister Lalonde to budge, and because External Affairs Minister MacEachen did not want to rile his colleague by pressing the matter. The issue acquired an added dimension at the ministerial level insofar as the regional bank governor has it in his power to ask one of his Cabinet colleagues or a parliamentary secretary to represent him at annual meetings held abroad — by no means an insignificant perquisite of office. What broke the logjam was the advent of a new government and the impending retirement of Mr. Lalonde. Privy Council Clerk Osbaldeston put the problem to Prime Minister Turner and was told to institute the agreement made earlier. On August 1, 1984, Finance lost the regional bank governorships to CIDA.

It was typical of the manner in which territorial disputes are resolved that there was an element of compromise in the resolution of this one. Turf battles seldom leave the interdepartmental process less complicated than it was before. The losing players have to be able to point to something salvaged, to preserve their reputations and stand as acknowledgment of the merits of their arguments.

As far as the policy changes that might be engendered by this outcome are concerned, it is too early to say with certainty. It would, however, be reasonable to expect the battle lines over the division of aid funds between bilateral and multilateral purposes to be somewhat blurred as CIDA’s interest in multilateral disbursement through the regional banks becomes more pronounced. We might also expect to see Canada’s position in regional bank meetings move somewhat in the direction of more concessional terms and easier criteria of assessment of borrowers.

Finance as Aggressor: The Aid-Trade Fund

Without exactly seeking to extend its own turf, Finance has recently infiltrated the territory of another organization with the initiation of the federal government’s aid-trade fund. In addition to shedding light upon the impact of the policy process on the substance of policy, the case lends considerable support to the contention that Finance prefers to act by means of fait accompli rather than through the open exercise of leadership.

In his budget speech of February 15, 1984, Marc Lalonde announced that the government would allocate up to one-half of an expected increase in official development assistance to a fund “to provide financing for proj-

ects which have high priority in recipient countries' development plans, for which Canadian firms are competitive, and for which development assistance financing is required.'" The idea of the fund had emerged from Finance's international programs division. It had its origins in the department's dissatisfaction with the lack of policy governing the Cabinet's award of mixed credits to Canadian exporters out of the economic development envelope, research showing that mixed credit on the incredibly advantageous terms being offered by competitor governments, such as the Japanese, made no economic sense at all, and the perception that CIDA was shortly going to have more money than it could spend as a result of the government's goal of disbursing 0.7 percent of gross national product as aid by 1990. Finance, in other words, was acting out of a concern for the judicious expenditure of public funds. What was projected was a pot of funds, to be administered by the Export Development Corporation (EDC), into which the Cabinet could dip whenever it wanted to do a mixed credit, in response to proposals from business executives on the point of concluding deals in developing countries. A major advantage over the prevailing practice was that the aid component of the credit would be seen as such, instead of masquerading as economic development funding.

The idea was developed and then put to the group in the Finance department drawing up the budget. The plan was to exploit the secrecy of the budget process and thereby avert intervention by CIDA or External Affairs. "We tried to ram it through," one Finance official said. The plan fell apart when the minister, though approving the proposal, decided that it should go to the priorities and planning committee of Cabinet. To pave the way, the proposal was shown to several senior civil servants. It aroused instant opposition from the undersecretary of state for External Affairs, who was backed up by his minister. Finance was accused of raping the aid program and damaging its integrity. There was an obvious collision between the proposal and CIDA's policy of an 80:20 mix of development assistance in favour of the poorest countries. Furthermore, External Affairs wanted CIDA to administer the program, and Finance feared the agency might use this as a safety valve to relieve the increasing pressure to make more of the aid program commercially relevant.

The upshot was that Mr. Lalonde's February 1984 announcement had to be rewritten to make it acceptable to Mr. MacEachen and his deputy, Marcel Massé. No mention was made of the EDC or mixed credit and the fund was painted as a new thrust in aid policy, a commercially relevant aspect of the aid program, whereas Finance had conceived of it as a way to use part of the aid program to accomplish commercial objectives. Furthermore, there have been a lot of twistings and turnings since that February budget, during which CIDA and External Affairs have each produced papers on the idea, and decisions on who will run the fund and how it will operate have been postponed until interdepartmental agreement can be achieved. Suffice it to say that the character of the proposal has been

markedly altered since it moved from the confines of Finance to the wider interdepartmental arena.

DRIE as Aggressor: The Case of the Japanese Autos

The interrelationship of trade and industrial policy introduces a special case of bureaucratic manoeuvring where no single department can claim an unchallenged lead because a competitor may well be able to neutralize its efforts, encroach on its territory, or take government policy off in a different direction altogether. The case of Canadian restrictions on Japanese automobile exports to Canada illustrates how DRIE could exploit its shaky mandate for investment policy to invade the bailiwick of External Affairs and bring about a profound reshaping of the Canadian stance on a major trade issue. Secondly, it is one of numerous examples of how the resolve, capacity and toughness of ministers can be a significant, probably the most significant, determinant of the course and outcome of bureaucratic warfare.

This case arose out of the increasing share in North American purchases of new cars taken by Japanese imports in the early 1980s. The consequent outcry from the automotive industry and labour unions led to Japan's agreement to curb exports to the United States and, in turn, to Canadian pressure for a similar agreement to be concluded between Japan and Canada. The first of a series of voluntary export restraint measures was, therefore, negotiated in 1981. The problem was far from settled, however, as evidenced by the deliberate slowdown in customs inspections in the Vancouver dockyard in 1982. There was also continuing dissatisfaction with the effectiveness of the restraints and pressure from the United Auto Workers and the Automotive Parts Manufacturers' Association for more assembly and purchase of auto parts in Canada by Japanese producers.

The instrument employed by DRIE Minister Ed Lumley to establish a purchase on the auto imports issue was a task force under Patrick Lavelle, president of the Automotive Parts Manufacturers' Association, which was appointed in December 1982 and reported six months later. The automotive manufacturers, the parts manufacturers and the workers were the only groups represented on the task force. Its appointment could be defended as a legitimate exercise of the Industry minister's responsibilities, but the report, which recommended that Japanese cars sold in Canada should have at least 60 percent Canadian content by 1987, served the purpose of thrusting Mr. Lumley into the centre of the most pressing trade issue facing the country.

The Lavelle report aroused a storm of protest. It was argued vehemently that content rules would be inconsistent with Canada's existing legal obligations, would provoke retaliation and would raise prices to the consumer. Moreover, content requirements were anathema in significant sectors of

the government. DRIE moved quickly, therefore, to set up an interdepartmental task force to develop policy to come after voluntary export restraints, which were to expire on March 31, 1984, and to respond to the Lavelle recommendations. The coordinator of this new task force was responsible to a steering committee of assistant deputy ministers, but he appears to have had frequent access to the Industry minister, and he saw his fundamental task as taking charge of the issue of Japanese automobile imports on behalf of Mr. Lumley. On taking up his new responsibilities, he first ensured that he had capable assistance in drafting the papers that would be needed if DRIE were to seize the initiative and head off opposition from the other departments.

The DRIE coordinator was assisted in getting his way because the Finance and External Affairs representatives on the task force either could not or would not carry out jobs assigned to them. Finance produced an analysis of why restraints would raise costs to the consumer and why the Lavelle proposal was bad, drawing on the U.S. and Australian experiences with no reference to the Canadian. External Affairs did not submit a promised analysis of how the Japanese could be expected to react to content legislation. Other participants in an interdepartmental working group are usually less strongly motivated than the representatives of the lead department, since it is the senior management of that department alone which will give the final product serious attention. The unwillingness of the External Affairs representative to join in the task could also have been explained by the overtones of personal bitterness between Mr. Lumley and Trade Minister Gerald Regan which the turf battle had acquired. In any case, the DRIE participants produced the major paper which formed the core of their report. The thrust of this report was that the threat of content legislation should be kept alive in order to encourage foreign investment of the kind that would spur Canadian automobile producers to become more competitive.

Once the recommendations stemming from the report had been approved by Cabinet, DRIE officials undertook their own mission to Japan to warn Japanese auto makers of Canada's new resolve, and also to set up a secret meeting between their minister and two presidents of Japanese auto firms. The cooperation of the Canadian embassy in Japan was the more easily obtained because the ambassador and Mr. Lumley had worked together when the latter was trade minister in External Affairs.

Within Finance and External Affairs, particularly within the latter's Asia and Pacific branch, there was vehement opposition to the Lavelle report. Taking this together with the tension already existing between Regan and Lumley, it is surprising that a stronger effort was not mounted to kill the report altogether. In Finance's view, the report was indeed effectively neutralized. The government was driven away from the domestic content option of Lavelle and the labour movement. Finance Minister Lalonde, backed up by several papers designed to establish the cost to the economy

of domestic content rules, faced down the opposition of the Industry minister and his protectionist colleagues, such as Francis Fox and Eugene Whelan.

DRIE officials see the matter differently. It was never their intention to make good on the threat posed by Lavelle. They were determined to drive home the lesson that Canada could not seriously expect to cope with Japan Inc. if equipped with no more potent instrument than the GATT. The central point in their view is that, whereas External Affairs continued to lead on the negotiation of export restraints, thenceforth this negotiation was placed firmly in the context of the policy framework developed by DRIE.

The DRIE assessment may smack of being after the event but it is nonetheless accurate. There are a number of circumstances which go together to explain the outcome. A key decision was that of the deputy minister for Trade to hand control of the issue to his economic and trade policy branch rather than to the Asia and Pacific branch. Japanese auto exports were viewed as belonging in the context of the automobile industry as a whole and, in any case, the economic and trade policy branch possessed much greater expertise on the subject. Coincidentally, the branch's assistant deputy minister had also worked in close association with Mr. Lumley. The deputy minister himself was a strong opponent of the Lavelle report but may have been handicapped in his dealings with Mr. Lumley by lack of a deep familiarity with the GATT. There were serious differences between External Affairs and DRIE concerning the number of automobiles to be let in (External Affairs was afraid that the government would get itself on a hook by stating too extreme a demand and having the Japanese refuse). These differences were eventually resolved at Cabinet level. The significant point, however, is that the officials charged with handling the matter at the working level in External were inclined to be sympathetic to the DRIE minister's objective of attracting greater investment to Canada.

Overhanging the bureaucracy's handling of the issue were the positions taken by the two competing ministers. On the one hand, Mr. Lumley had a reputation for being tough on his officials and this time he had taken a strong stand. He was prepared to risk the enmity of ministers and officials by by-passing interdepartmental committees and the relevant central agency, the Ministry of State for Economic and Regional Development, and taking the recommendations of the post-Lavelle task force directly to the Cabinet level. If the other departments did not always fight as hard as they might have, it was presumably because Mr. Lumley appeared to be capable of defining the terms of the discussion within Cabinet.

Mr. Regan on the other hand, apparently caught between his senior officials' opposition to protection and the desire to ingratiate himself with his protectionist colleagues in the Cabinet, did not give a strong lead. Possibly in order not to alienate support he would need in a run for the leadership of the Liberal party, he departed from the position his officials had adopted on his behalf. The debate within the interdepartmental task

force was over how various concessions demanded from the Japanese would affect the timing of the introduction, passage and proclamation of the content legislation. DRIE gave some ground on these points in a vain attempt to get the Trade minister to co-sign the accompanying memo to Cabinet. When the recommendations did reach the Cabinet level, however, Regan turned the tables on his officials by arguing that they were, in fact, not tough enough. The degree and manner of politicization of the issue had given a greater advantage to one side of the debate than the DRIE bureaucrats had anticipated.

An Assessment of Bureaucratic Politics

Foreign economic policy from the bureaucratic politics perspective is viewed not as the product of a rational calculation but rather as the result of a process that is prone to be chaotic and unpredictable, characterized by trade-offs and bargains and the intrusion of influences that have little or nothing to do with the issue at stake. The exigencies of the game threaten to obscure the fundamental objective which is being sought. Political leaders are in danger of losing control over policy making and, by the same token, their accountability for policies for which they hold formal responsibility is cast into question. Moreover, coherence and consistency in foreign policy may be compromised by the way in which the governmental process works.

The purpose of this concluding section of the paper is to examine how far the theory of bureaucratic politics accords with our empirical observations of foreign economic policy making. Are ministerial accountability and control, both important ingredients in the workings of ministerial responsibility, placed in jeopardy by the way in which bureaucrats carry out their tasks and pursue their interests, particularly their interest in the protection and extension of their territory? Is the attainment of the desirable degree of coherence and consistency in foreign economic policy similarly confounded by the way in which the bureaucratic game is played?

The paper concludes that these are manageable problems, requiring not so much new rules governing bureaucratic behaviour as effective political and bureaucratic leadership. The perspective of bureaucratic politics, however, yield insights that can be used to make improvements in the policy-making process by reallocating some responsibilities and by exercising others more energetically.

Ministerial Control

The actual degree of ministerial control of the bureaucracy varies with the capabilities and intentions of ministers. Some impose their personal goals on their departments, some simply reflect the opinions of their officials,

and there is a third category, introduced in the foregoing pages, composed of those who defer to domestic political imperatives and whose views are unconnected to those of their professional advisers. The test of whether bureaucratic politics jeopardize ministerial control is, however, the responsiveness of officials to political direction. This section begins an exploration of ministerial-bureaucratic relations, and the following section refines our conclusions in terms of the effects of different decision-making structures.

Ministers have sometimes directed attention to practices such as the tardy provision of information or the sudden announcement of an impending deadline as evidence that officials ostensibly under their control are, in fact, marching to a different drummer.²⁶ The fact remains that, though bureaucratic behaviour creates management problems, ministers continue to bulk extremely large in the governmental process. A strong minister can render his department totally responsive to his policy views and even turn the department completely around, as Jean Chrétien is reported to have turned Finance around (temporarily) on the issue of protection against low-cost imports in the late 1970s. Even when a minister is ineffective, there is a powerful tendency for officials to seek to carry out his will, and to strive even harder to discover what his will is. Arguments between officials are often decided on the basis of the anticipated reactions of ministers. In the three case studies, the positions taken by ministers were decisive in resolving the issues and, to a considerable degree, in determining the course which each issue took.

Bureaucrats are, of course, often engaged in trying to influence ministers and to press new ideas on them. One element of bureaucratic skill is knowing the best time to strike. A task force in the United States branch of External Affairs, for example, devoted the summer of 1984 to the preparation of a paper so that it could be ready to suggest actions a new government could take in respect of Canada-U.S. relations. The branch's assistant deputy minister circulated the draft paper to his allies in the department before submitting it to the three deputy ministers. The danger in this kind of exercise of influence is not that of a lessening of ministerial control but rather of a dilution of the views officials set before ministers, in order that these views should carry the weight of departmental support. The fact that officials often mobilize their skills and arguments to sway the opinions of ministers shows that bureaucratic politics are tailored to conform with ministerial control, not that they subvert it.

It is a telling sign of the importance of ministers that the assessment and mobilization of influence at the bureaucratic level hinges almost entirely on how this is likely to affect the way that Cabinet divides on an issue. Bureaucratic allies are sought primarily for the weight they may carry with their minister, or with ministers collectively. The views of the Canadian embassy in Washington, for example, can be a powerful factor influencing Cabinet committees confronting Canada-U.S. issues. Most ministers have visited the embassy, some might even solicit its views by telephone on their

own, and others can be counted upon to ask whether the position being put forward has the embassy's support.

Ministers themselves can possess influence that transcends their prerogatives and powers. Bureaucrats do not invariably regard them merely as objects to be cajoled, convinced, flattered and kept supportive. Ministers with good political judgment are respected for that judgment and it can strongly influence the thinking of officials. This applies particularly to ministers' assessments of how a foreign government would react to a Canadian initiative. A Cabinet member with good connections to a U.S. administration will, for example, have close attention paid to his assessment of opinion within that administration.

To be sure, officials not infrequently conspire to bring wayward ministers into line but, to do so, they must be able to recruit their own minister to the cause, and he must be able to muster the support of his Cabinet colleagues. To look at the other side of the coin, credibility with ministers matters a lot. J.H. Warren was, for example, a successful Canadian coordinator for the multilateral trade negotiations partly because he had the full support of Allan MacEachen, chairman of the Cabinet committee overseeing the negotiations. By the same token, a senior official who adopted a controversial position, or attempted an important policy initiative without being able to claim the support of his minister, would almost certainly be going nowhere with his own colleagues in the public service.

There are some circumstances where the bureaucratic game could conceivably become so absorbing as to weaken the control of ministers, not because territorial battles have to be fought but because territorial sensitivities have to be mollified. Take, for example, bureaucratic foot-dragging. The policy-making process is, at times, much slower than ministers would like it to be. Both the exercise of producing the trade policy papers and the development of the sectoral trade initiative, for example, dragged at first. Senior officials from External Affairs thought it necessary to proceed with extreme caution so that no other department would feel threatened. Quite apart from the exigencies of mirror committees and central agencies, an enormous amount of time was spent cementing personal relations with lunches and telephone calls, so as to allay fears that External Affairs was trying to get too far out ahead. In such a case, a minister might well have complained that extraneous factors were being allowed to interfere with the fulfillment of his orders.

The remedy for a policy process grown too long and tortuous consists, however, not in taming bureaucrats but in better management of the issues. The initiation of a policy exercise should be clearly seen to take place at a high level in order that more junior officials take it seriously and devote attention to it. Similarly, should interdepartmental discussion run into a snag, this is much more likely to be overcome by officials at or near the top of their departments who can develop informal liaisons to circumvent formal structures. Early on in the process, however, there is a need for

the proper spadework to be done in the form of written papers, in order to prevent senior officials from talking around the problem and failing to come to grips with it.

It similarly holds that a minister endeavouring to develop new policy may find his efforts neutralized by the bureaucracy unless he is firmly resolved to shortcut standard operating procedures. Otherwise, interdepartmental differences will be resolved through the exercise of drafting, which will leave the final document containing something for everyone. When controversial papers, such as the report of Ed Lumley's post-Lavelle task force, do arrive at the Cabinet level, it is normally because a senior official or minister has watched over their development and has been prepared to break the rules to push them through the system. If there are suspicions to be overcome at the official level, however, these normally reflect suspicions at the Cabinet level. There is always a chance that the bureaucratic game will get out of hand but, for the most part, it is a mirror image of the political game, so that the problem of ministerial control, if such exists, should not be ascribed primarily to the machinations of officials.

Accountability and Collective Decision Making

The principle of accountability requires that officials should be answerable to their ministers and that their ministers should be liable, jointly and severally, to be called to account for the actions and policies of the government. Accountability is not an invariably useful principle if it applies solely at the general level at which we have been examining the control exercised by ministers over their officials. The usefulness of ministerial accountability depends on being able to pinpoint exactly who should be accountable and to whom. Collective decision making applied to Canada's foreign economic policy has increased the possibility of bureaucratic behaviour inconsistent with strict accountability, but again the remedy consists in stronger ministerial leadership.

Two models of decision-making structure are reflected in the foreign economic policy process. In the first or traditional model, strong departments develop policy with their own resources and within their confines, subject of course to the normal constraints of Cabinet government. In the second or collegial model, policy is expected to emerge from a committee on which the relevant departments are represented. The first model is identified with the early post-World War II period of Canadian government and continues to have a powerful influence on the thinking of officials, particularly in the Department of Finance. The second is a product of the Trudeau era, which witnessed a strengthening of the Cabinet committee system and the multiplication of central agencies. There is fierce and continuing disagreement over the merits of these models within the government.

A major advantage claimed for the traditional model is its clarity concerning who is in command. Accountability is tied to a department's minister, who must accept it. On the other side of the ledger, detractors argue that a weak or inexperienced minister can become the prisoner of his departmental officials. If this is the case, the answer may be to give the minister a strong personal staff, including people on secondment from the public service.

The core of the argument for collective decision making is that ministers can be expected to develop a firmer grasp of policy directions when they are acting together rather than as individual recipients of advice from their departments. Greater self-confidence and stronger resolve come from jointly arriving at government positions. This contention is borne out by the manner in which the federal Cabinet has handled the problems of the textile and footwear industries.

One consequence of collective decision making, however, is that the responsiveness of officials to their minister is sometimes dislodged by a greater responsiveness to other ministers or to the ministry as a whole. The lines of allegiance can become crossed when a major policy initiative is under way and there is disagreement among ministers. Despite the significant premium placed on loyalty, if a minister's lead is weak, or if he has acquired a reputation for unpredictability, there is an incentive for an official to attune himself to the kind of thinking that appears to be carrying the day at the Cabinet level. We have more than a suggestion of this in the way that some parts of External Affairs appear to have cooperated with Industry Minister Lumley's strategy for obtaining Japanese investment in the Canadian automobile industry.

The allegiance of an official to his own minister could be relaxed further by the manner in which bureaucratic resources are marshalled to tackle emerging issues of importance. The policy community tends to shift to where the issues are and, as we have seen, one of the primary requisites for a department to get control of an issue is to mobilize the relevant expertise. It is a reasonable conjecture that the movement of officials in and out of departments has made it less likely that they will feel automatically and exclusively accountable to the minister under whom they are currently working.

The ties that bind bureaucrats to their departmental minister are, indeed, considerably relaxed by the Cabinet committee system which permits, and sometimes encourages, officials to express views different from those of their political superiors. Ministers not infrequently fail to speak to their own department's recommendation, and may even deliberately absent themselves when these come up. Less often, they may say, "My department recommends this course of action, but I feel differently." Officials in disagreement with their minister can even avoid the embarrassment of initiating an open dispute with him because they can usually count on one of his colleagues to invite them to express their views. Furthermore, when

an issue overlaps the purview of several departments and is handled by a coordinating mechanism it becomes more difficult to link an individual minister directly with a specific policy and, by the same token, ministers are able to walk away from issues with which they are uncomfortable.

In sum, the wedge that collective decision making drives between individual ministers and their departments has occasionally made it possible for officials to ignore their accountability to their departmental ministers and for ministers to evade accountability for actions joined in by their departments.

The contours of the bureaucratic game are shaped by the structure of decision making. Collective decision making increases the chances of tight control of the governmental machine by the Cabinet, but fractures accountability and renders the decision-making process more opaque in the eyes of the citizen. With unitary decision making, accountability can be clearly ascribed but, practically speaking, there is a greater likelihood of initiative slipping away from a department's minister in the direction of his officials.

Unitary and collective decision-making systems are bound to persist in uneasy coexistence in the conduct of Canada's foreign economic policy. The former will survive if for no other reason than that an enormous upheaval would be required to get Finance to share the powers and responsibilities of its minister. At the same time, despite the exasperation of officials with the conciliar approach, the complexity and dimensions of issues confronting Canada in the evolving world economy will require a substantial degree of collective decision making. The issues will only be manageable if bureaucratic resources can be mobilized across a wide spectrum of governmental activities.

The main task is going to be to get ministers to make a rapidly increasing number of decisions instead of avoiding them. The discipline imposed by committees and central agencies will be essential for this purpose. Furthermore, political leaders are never going to tolerate the load of arbitration they will have to carry if strong departments are allowed to act on their own and inevitably rub up against one another. Pressure coming from the prime minister, in particular, will be directed at putting a considerable distance between himself and a large number of important decisions. If nothing else suffices, this will enforce a collective approach. There will, however, be a risk to be run. In the absence of firm direction, relaxing and jumbling formal lines of accountability will give greater scope for some of the classic manifestations of bureaucratic politics, including end runs and interdepartmental alliances.

Coherence, Consistency and Coordination

Bureaucratic politics in the Canadian government will inevitably pose a problem for the coherence and consistency of policy as long as there is

an imperfect fit between the capabilities and responsibilities of departments on the one hand, and the dimensions of the most pressing policy issues on the other. The three examples of territorial conflicts demonstrate that the basic fault lines in the government are still departmental, notwithstanding the occasional alliances that can be formed between ministers and officials of another department. The tendency of the bureaucratic game is, in many respects, to reinforce departmental divisions.²⁷ Influence is mobilized at the departmental level, and the object of influence is almost invariably another department. Departmental tensions worsen, and are worsened by, ministerial tensions such as those existing between Lalonde and MacEachen or between Regan and Lumley. Competition between departments is continuous and, as happened in each of the three cases, occasionally leads to a shift of responsibility for policy, which in turn brings an alteration in the policy itself.

There are a number of correctives to the excesses of bureaucratic politics. Some are institutional devices, such as the coordinating committee of deputy ministers, which meets weekly to keep the governmental process under review. Others are practices such as that of the Trudeau government to assign deputies for fairly short periods, so as to moderate their territorial instincts. More significantly, the bureaucratic culture lays great stress on the coherence and consistency of policy. Indeed, a lot of the cut and thrust of bureaucratic politics is provided by arguments about whether a proposed course of action is consistent with past policy and how well it fits into present policy. In a case such as that of the Japanese auto imports, though the competition between DRIE and External Affairs may have caused some confusion to the Japanese, Canadian officials worked hard to keep the efforts of the two departments reasonably in tandem and complementary. At times, bureaucratic politics can even be put to the service of coherence and consistency in policy.

At a deeper level, it is hard to escape the sense of Canada's vulnerability to international developments that pervades the bureaucracy. The fear that an external force, particularly the government of the United States, will wreak havoc on Canada unless its policies have been pulled together and made consistent one with another probably has the effect of tempering bureaucratic competition.

It is necessary to get this problem of consistency into perspective. By comparison with other factors that force policy off course, its dimensions do not appear too great. The principal such factor is a lack of clearly formulated goals and strategies, a statement of Canada's economic priorities. On a question such as the extent to which commercial objectives are to be allowed to govern Canada's dealings with developing countries, for example, the Trudeau government did not really have a settled view. The absence of such fundamental policy directions cannot be laid at the door of bureaucratic politics.

There are nonetheless improvements that could be made in the structure of decision making to bolster the coherence of foreign economic policy. This paper makes three recommendations:

1. The Privy Council Office, under the direction of the Cabinet, should undertake a more strenuous effort to enforce a clear division of labour and expertise among the economic departments.
2. The position of the coordinator of international economic relations should be strengthened and the locus of coordination should be moved from the Department of External Affairs to either the Privy Council Office or the Department of Finance.
3. The Department of Finance should exercise more energetically its responsibilities as the leading department of state in the making of Canada's foreign economic policy.

In the first place, it is essential that the duplication of departmental capabilities be contained. The need for departments to mount joint attacks on major problems has made some duplication inevitable, and partly accounts for the "miniature replica" effect, whereby departments have spawned divisions and sections that mirror other departments. Collegial decision making has strengthened the trend. The rationale that overlapping expertise is needed to make possible communication between departments can, however, be infinitely extended to justify hiring more and more people.

A number of departments, among them Agriculture, Energy, Mines and Resources, Communications, Fisheries and Oceans, Environment, and Labour, cling to their international units. In this respect, the consolidation of the conduct of Canada's dealings abroad has been left incomplete. The process of domestic ministries extending their jurisdictions to include international policy has gone further in other countries, where it has exacerbated conflict and made decision making more complex.²⁸ Though External Affairs has sometimes been able to mitigate the effects of duplication through secondments of its own officers to other departments, such international units, unless tightly controlled, will make it easier for departments to compete in their assessments of situations and in their prescriptions for action.

A more direct attack on departmental parochialism consists in mechanisms of coordination, intended to draw the strands of policy together and impose both coherence and consistency. When a minister must sort matters out with his colleagues everyone becomes aware of the ultimate aim, and this knowledge extends down the line of the departments, making it harder to conceal private or sectarian motivations. A willingness to pull together is strengthened by the clout of central agencies, which can sometimes go so far as to influence the careers of individual players.

The efforts of External's coordinator of international economic relations to get departments working together in a common endeavour have, however, been stymied by those departments putting their organizational interests first. The government's intentions with respect to filling this position are unclear, though, at the political level, the External Affairs minister retains the responsibility for coordination. A decision not to name an official as coordinator could be a step backward, not because a smoothly coordinated foreign economic policy is ever fully attainable, but because new, more comprehensive forms of coordination, needing the backing of a major bureaucratic actor with clout, could well be required in the future.

Beyond question, an effective coordinator would have to have more instruments of influence, including a legislative mandate that recognizes that international trade, international finance and macroeconomic coordination are inextricably intertwined. The position of coordinator should also be combined with that of the "sherpa" or prime minister's personal representative for the Economic Summit. The two roles were for a short time held by the same individual, but the practice has been to rotate the sherpa's position among senior officials every two years or so. If such a reform were to be carried out, this would add considerable substance and clout to the job of coordinator. It would afford special access to the governments of the participating countries through meetings of the seven sherpas, which take place quarterly. Most important, the prime minister's mandate to organize Canada's Summit preparations would strengthen the coordinator's hand in getting the attention of the departments and forcing them to concert their ideas and energies.

The question of which department should undertake coordination is best answered after examination of the task itself. In their study of how Canadian economic policy is made, Professors Phidd and Doern make it clear how difficult it is to achieve policy coordination and how this can, at best, amount to a succession of wins and losses for the participants.

It is clear that the political meaning of coordination can only be contemplated when one acknowledges that such coordination involves in part the temporary victory of one or two economic objectives over other values and objectives, the use of one or more instruments over other instruments, and the relative triumph of one department over another and of one or more ministers over others.²⁹

It is precisely because coordination is characterized by continuing inter-departmental strife that the locus of coordination has to be in a department with an acknowledged reputation for impartiality. There has to be confidence that there is no bias among those who "hold the deal," and there has to be confidence that there is an institutional memory in which the deal is recorded. Bureaucrats who have conceded a point want to be sure that their broad-mindedness will be remembered going into the next round.

External Affairs cannot thus expect to be able to provide effective coordination of international economic policy and, at the same time, consistently press its own policy preferences and its own territorial ambitions. The more External has its own set of axes to grind, the more predictable an actor it will become and the more other departments will build their own defences against it, in the form of newly contrived mandates and newly acquired expertise. The more External seeks to take control of an issue, the more other departments will become wary in their stance and rigid in their views and, in the absence of outside pressures, there will be no way to compel everyone to think along the same lines.

There are two stronger candidates for the task of coordinating foreign economic policy, both of them central agencies, which can claim greater impartiality than External: the Privy Council Office and the Department of Finance. The former setting would have the advantage of easier access to the prime minister combined with a salutary distance from any of the departments. The coordinator would be in a strong position to curb territorial disputes and to shape the process of policy formation as well as the policy output. There would also be a good chance of a constructive debate between three clearly articulated positions: the need to respond to the international environment being upheld by External Affairs, DRIE pressing the case for domestic economic development, and Finance focussing its attention on management of the economy.

The advantage of situating the coordinator in Finance is that comprehensive coordination of foreign economic policy is inconceivable without a degree of control of the greatest concentration of policy instruments. If the job were combined with responsibility for the international activities of Finance, there would be a possibility of coordination of almost the whole range of Canada's international economic relations. The corresponding disadvantage is that the assertion of Finance's primacy in foreign economic policy would leave External Affairs more than ever uncertain of its role, and mortally weaken its advocacy of an international discipline. Finance's impartiality could not, moreover, be ensured unless it were to shed its import responsibilities and link its participation in interdepartmental debate solely to its highest priority task of macroeconomic management. Otherwise, the latter mission would conflict with its custody of the tariff and its responsibility for policy on contingency measures and, at times when the department's attention was diverted from the international economy, the import policy tail would assuredly wag the foreign economic policy dog.

To exercise interdepartmental leadership it is not necessary to be the lead department. Whether or not Finance provides the locus of coordination, the most promising reform that could be made to the process of foreign economic policy making would be to push that department into the leadership role it has long shunned. Finance not only is in the strongest position to mobilize influence throughout the government, but also it has

the resources and perspective to enable the development of a comprehensive intellectual framework for policy. Furthermore, Finance is able to escape the bureaucratic sensitivities that frequently make it impossible for other departments to take novel and integrative approaches to problems.

In the last analysis, Finance holds a veto over serious progress in tackling the underlying issues of Canada's foreign economic relations. How much better then that the department with the firmest purchase on the problems should take the lead in resolving them! Acceptance of such a role will require a significant reorientation for Finance, which has been too narrowly focussed on domestic policy and too much disinclined to join in inter-departmental decision making. More attention needs to be paid to the linkages between foreign and domestic policy, to bring other departments along, to act and lead collegially. The need transcends the requirements of the bureaucratic game. Whether Canada is capable of formulating a coherent approach to the world economy will be dependent in no small degree on whether Finance can combine decisive leadership with a talent for getting along with other departments through patient persuasion and negotiation.

Notes

Although this paper was virtually completed in November 1984, a few amendments were made thereafter that refer to later events.

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1. See Allison (1971). My discussion of the bureaucratic politics approach draws heavily from this source.
2. See Nossal (1979), p. 623.
3. Dr. A.W. Johnson, a retired public servant who was once assistant deputy minister of Finance, has written of the tendency of ministries to represent their own bureaucratic interests at interdepartmental policy committees: "This is particularly true if these ministries assign to any committee of officials relatively subordinate or insecure officials — officials who are afraid to commit their ministries even to the possibility of modifying their ministries' policies" (Johnson, 1978, p. 9).
4. Possession goals relate to the enhancement or preservation of national possessions and milieu goals relate to shaping conditions beyond national boundaries; see Wolfers (1962), pp. 73–74.
5. See Hines (1984), pp. 29–34. A similar point with respect to the specific case of fisheries is made by Keating (1983–84), p. 163.
6. See Phidd and Doern (1978), p. 204.
7. *Ibid.*, p. 209, quoting Michael Pitfield.
8. Bank of Canada (1981), pp. 3–4.
9. The resignation, on November 14, 1984, of the governor of the Bank of France following a dispute over the government's plan to engineer a reduction in interest rates substantiates this point.

10. "Reorganization for Economic Development," press release, Office of the Prime Minister, January 12, 1982.
11. See Hines (1984), pp. 44–46.
12. See Hart (1985), p. 234.
13. See Protheroe (1980), p. 72.
14. This was, for example, the tactic employed in drawing up recommendations for a new policy regarding the renegotiation of textile import quotas in 1981. In the end, ministers accepted the option recommended by the low cost imports committee but toughened it by reducing the size of the overall quota.
15. In the words of one senior official, "When we are working an issue through the system we know we will be seen by the Cabinet as boy scouts."
16. See, for example, Hines (1984), pp. 104–11.
17. Finance is firm in its insistence that the Canadian executive directorship of the Fund should go to one of its own officials. The department's grip on the similar post at the World Bank is not quite as firm but it was able to make use of the recent change of government to have overturned the political appointment made by the Liberals.
18. "Monetary policy is rather like a hanging mobile, with each element — interest rates, money supply, exchange rates — in a deliberate balance. A move by one affects all the others": *Financial Post*, June 18, 1983.
19. *Bank of Canada Act*, 14 (2).
20. *Financial Post*, July 7, 1984.
21. *Financial Post*, June 18, 1983.
22. *The Department of External Affairs Act*, section 10.
23. My interviews with Privy Council Office officials provided conflicting evidence on this point. On the one hand, the view was expressed that the coordinator's possible excursions into the monetary and international macroeconomic area would trigger a healthy competition of ideas. On the other hand, it was also affirmed that the coordinator had been told that the trade community was her main constituency. In a 1982 article on the reorganization, Gordon Osbaldeston, then undersecretary of state for External Affairs, described the new position in ambitious terms. "Its incumbent," he writes, "acts as coordinator right across the government spectrum of the interests of all the various departments concerned with different aspects of Canada's international economic relations" (Osbaldeston 1982, p. 462).
24. See Hartle (1979), p. 76.
25. The information on which these case studies are based was obtained from interviews with officials from the relevant departments.
26. See, for example, MacDonald (1980), pp. 29–31.
27. See Hartle (1979), p. 74.
28. See Blaker (1978), pp. 144–49.
29. Phidd and Doern (1978), p. 115.

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The Foreign Service and the Organization of the Foreign Policy Community: Views From Canada and Abroad

ROBERT BOARDMAN

Introduction

A changing agenda of international relations, and an enhanced complexity of both issues and process: these have become the norms of late-20th century observers and practitioners of foreign policy. They form the basis for continued debate in Canada as in other Western countries on the character of diplomacy and the shifting requirements for external representation. The decade and a half since 1970 has witnessed a number of attempts, some tentative, some perhaps overly ambitious, to bring a greater measure of institutional coherence into the processes by which Canadian foreign policy, and foreign economic policy more particularly, are made. There have been similar kinds of exercises in the United States, Britain, the Federal Republic of Germany, Australia, and elsewhere. The refrains are often strikingly similar as we move from country to country. What are foreign ministries for? Are they outmoded? How can their staffs be made more responsive to business communities? What about divisions of labour between foreign ministries and the many other government departments which fish in foreign seas?

In practice, foreign ministries do not get abolished. All states have them. Lack of funds, rather than preference, prevents many countries from having many more overseas missions. The abolition or retention of foreign ministries is thus a false choice. Yet it is instructive to rehearse the case for the former option. It has been nimbly paraphrased by James Eayrs in a recent history of Canada's Department of External Affairs:

A foreign office, while not necessarily a frill of government, is an optional part of state apparatus. Any government could conduct its foreign affairs without a ministry created expressly for that purpose. Its leaders could rely instead upon their own resources and those of their staffs to supervise and

coordinate departments of trade, defence, immigration, agriculture, fisheries, and any others doing the country's business abroad, resorting again to their own resources to attend to any residue that might show up as "foreign policy" pure if not so simple. As the agenda of diplomacy changes . . . as the pace of diplomacy quickens . . . and as the level of diplomacy rises . . . critics contend that it is no longer necessary to entrust the management of external relations to an elite sector of the public sector. They even contend that the foreign office is obsolete.¹

Questions of foreign service morale have, not surprisingly, been interspersed in such debates like tropes in a medieval liturgical chant. The report of the Royal Commission on Conditions of Foreign Service in 1981 urged that "concrete steps be taken to correct the widely held view [on the part of officials of the Department of External Affairs] that those in positions of power consider the activities and the product of the foreign service as largely irrelevant to federal government or Canadian objectives."²

Problems of external representation, and the institutional arrangements at home which underpin the conduct of foreign policy, are not obscure ones of interest only to specialists in public administration. Indeed, in an interdependent world economy, such matters are probably of growing importance: if the Canadian economy is to flourish into the next century, then more, rather than less, oil has to be applied to the hinges that link it to the economies of the United States and the Western world generally. At the same time, the skepticism that greeted the reorganization plans for the Department of External Affairs in 1982 also serves as a reminder of the limited extent to which institutional hammering and tinkering can effect improvements in the product.

The aim of this paper is to review changes in the past few years in the organization of the Canadian foreign service, and in the foreign policy community in Canada and a number of other Western countries. The approach is a comparative one, for three reasons. First, foreign service reviews and evaluations of changing external representation requirements have been a persistent, or chronic, feature of many Western countries during the past couple of decades. These shed useful light on the organizational issues confronting the Canadian federal government. Second, similarities can be identified, though it cannot be assumed that organizational remedies in another country are transferable to the Canadian context; an institution or agency in any given country may have no direct counterpart here. Third, the raw data of organizational accounts, recommendations and critiques in various states have formed a common reservoir out of which some governments have tapped ideas, or on the surface of which have studied critically their own reflections.³

Examples have been selected from a number of countries: the United Kingdom, the Federal Republic of Germany, Australia, Japan, the Netherlands, Ireland, Denmark, and New Zealand. Appraisals in the first three of these are of particular interest because of shared traditions of parliamen-

tary and cabinet government (Australia and the United Kingdom), the political and constitutional context of federalism (Australia and West Germany), the impact of complexity in issues and policy environments which has preoccupied observers of processes in all, the various attempts made (especially in the United Kingdom) to turn foreign policy machinery into a vast export promotion apparatus, and the constraints on relatively newly established foreign ministries (as in Australia) in carving out for themselves coordinating roles in relation to domestic government departments with external functional responsibilities. We look first in general terms at the changing nature of external representation, and this will lead us into a review of the organizational debates and changes in Canada that have prompted this study.

The Changing Nature of External Representation

The character of diplomacy has changed and is changing. Yet, some apparently modern aspects of diplomacy have historic roots which may go back in some cases to the origins of diplomatic contacts between states. These include violence against the officials of governments, the use of embassies for political intervention in the affairs of host states, the spread of multilateral diplomacy and protracted international conferences, and attention to trade and the international economy.

Some images of the nature of diplomatic activity arise from distortions of what appears to have happened in earlier times. Entrants to diplomatic services may for this reason be attracted by unrealistic notions of the nature of the job. They may therefore be more vulnerable than their counterparts on the domestic side of government to mid-career disenchantments, with consequences for morale and the effective workings of foreign ministries. Public suspicion of diplomats as cookie-pushers has not usually had much impact on the work of foreign ministries, but it can restrict their capacity to sustain support when confronted with cost-cutting ministers. Similarly, because business executives may have a hunch that embassy officials are not of much practical use, they may not even get tested by a business executive operating abroad, and the potential for collaborative endeavours between government and the private sector may thus remain untapped. Yet another impression, that diplomats can work against a nation's best interests by emphasizing contact with adversaries, may be translated into concrete hostile measures if shared by a determined prime minister.

As one Japanese diplomatic historian has observed, the tendency for a foreign office and its diplomatic service to stagnate and decline seems to be a world wide phenomenon.⁴ Yet if we ask "decline from what?" the answers can be elusive. Attempts to define a classical mode of diplomacy stumble against some awkward historical facts. The boundaries between the foreign and the domestic policies of governments have probably never

been as fixed in heaven as some accounts of the hermetic seal around the nation-state would like to maintain. But let us identify seven assumptions that have helped to shape the traditional practice of diplomacy.

1. Foreign policy is distinct from domestic policy.
2. At the core of the foreign policy agenda are issues of war, peace, and the mitigation of international conflict — international relations is about power.
3. In carrying out their tasks, it is important that missions abroad enjoy a measure of autonomy from the foreign ministry.
4. Administrative separation of home and overseas civil servants is desirable.
5. The qualities required of the diplomat and foreign ministry official are those of the generalist with a political touch.
6. It is desirable that foreign policy and the conduct of diplomacy be assured some degree of insulation from the caprices of party politics and of public opinion.
7. Contacts with foreign countries, whether by private organizations or by agencies of government, should be channelled through and coordinated by foreign ministries.

The more general factors that have brought about what Hans Morgenthau called the crisis of diplomacy include the development of communications technologies, a widespread downgrading of diplomacy, the rise of parliamentary diplomacy, the diplomatic styles of the superpowers, and the changing character of contemporary world politics.⁵ Still more significant factors making for change in the long term have to do with the changing requirements of national economies. Since the 1930s it has been impossible to conceive of economic policy making exclusively in national terms. Since the end of World War II the international dimension has grown substantially. Matters formerly of domestic concern, such as the state of the budget in the United States, are in the 1980s high-priority concerns for all Western governments. Matters formerly of interest primarily to specialist officials, such as the volume and type of goods traded with other countries, have become central to the main agendas of foreign ministries.

In the process, departments of government other than foreign ministries have emerged as significant foreign policy actors. This has served to undermine the traditional authority of foreign ministries and diplomats and the ways in which countries handle their external relations,⁶ but it has also added to their tasks. One Irish MP commented, in reference to his country's diplomats in the 1950s, that their duties had formerly been directed toward advancing the recognition of the state, but that recently a new duty had been imposed on missions abroad: that of advancing Ireland's trade potential.⁷ The question is central to that of how best to organize foreign ministries. As the report of the Royal Commission on Australian Government Administration (RCAGA) noted in 1976:

The difficulties in designing appropriate machinery for the formulation and conduct of foreign affairs arise from the problems of identifying where such affairs begin and end. There is almost no subject matter, however closely identified with the traditional diplomatic interests of a Department of Foreign Affairs . . . which does not contain a substantial component of domestic concern. . . . Equally of course there is almost no aspect of domestic policy which does not, or could not, in some circumstances involve issues of important international concern or of significance in our relationship with particular foreign countries.⁸

Thus while government organization has traditionally rested on the separability of “foreign” from other policies, developments have continued to erode the utility of the distinction. A paper written for the Murphy commission on United States foreign policy organization in 1975 argued that, “the management of interdependence is increasingly a multilateral process. Our foreign policy is increasingly intertwined with domestic policies and economics and social policy — and vice versa.” However, “despite the imperatives of interdependence and multilateralism, U.S. foreign policy is managed on two assumptions quite inconsistent with them. The government is divided between domestic and foreign policymaking, up to and including the White House staff.”⁹ The Central Policy Review Staff (CPRS) report in Britain in 1977 observed that the rationale for organizing government on sectoral lines was grounded in considerations of administrative and policy making efficiency. Overseas affairs, however, “fit awkwardly into this picture . . . many aspects are merely extensions of domestic sectors.” Thus “the sectoral approach to the organization of Government would suggest that self-contained overseas functions should be performed by a separate overseas department (or departments), and that the other functions should be performed by the appropriate domestic departments.”¹⁰

Coordination has been the slogan under which reorganization strategies usually have been sought by foreign ministries. It is a formula, critics maintain, which has been used to legitimize foreign ministry claims to administrative territory that arguably might be better managed by other departments. Effective interdepartmental collaboration can be hindered because of processes that are inherently protracted, the divergent contexts of differing departmental philosophies as well as policy goals, and the hope for protection in the last resort from a department’s own cabinet minister. Formal mergers or departmental takeovers do not necessarily help significantly; competition for preferred outcomes may, if grounded in long-differing styles and traditions, be as intense in fully integrated super-ministries.

The most intractable organizational problems have arisen in relation to foreign economic policy. Should export promotion be the responsibility of trade departments or of foreign ministries? How should the latter fit into the pursuit by governments of broad economic objectives on exchange

rates, interest rates, protectionism, capital movements or international debt problems? Within foreign ministries, should functionally based divisions supersede organization along geographical lines? Or has this process been taken too far already?

Organizational issues have also arisen as a result of the emergence of channels of contact and communication between states and societies other than those traditionally viewed as the monopoly of the diplomatic world. A fisheries ministry or finance department will have its own international roles. A related factor has been the activities of foreign ministers or prime ministers in the formulation and execution of foreign policy. The rapidity of modern communications also casts doubt on the viability of embassies in their traditional form. How much autonomy should an overseas mission be allowed? Further, non-governmental groups have increasingly instituted their own forms of contact with targets or counterparts in foreign countries. Foreign service officers abroad may find themselves working side by side with a parallel private sector network, either directly from companies themselves or more indirectly in the form of overseas branches of chambers of commerce. Finally, multilateral negotiating sessions, for example those on the law of the sea or the force reduction talks in Vienna, increasingly seem to be of such duration and complexity as to alter the traditional character of international negotiations.

These kinds of developments provide ammunition to critics of foreign ministries. This is part of a broader picture. Complaining about government seems to be so widespread in so many countries, and to be so satisfyingly therapeutic for the grumbler, that the social engineer of the future might be ill-advised to eradicate the circumstances which produce it. One is reminded of the critical attacks in the Soviet media on the failings of the Soviet government, though not of Communist Party officialdom. Diplomats tend to be more sheltered from criticism because of a relative public indifference to foreign affairs, but they are not immune. Recruited from a restricted social class base; concerned with style rather than substance; ignorant of economic principles; affecting academic mannerisms rather than a substantive sobriety; too ready to condemn the obviously right policy move as inappropriate or untimely; disdainful of public commentary; as alert as landed gentry to jurisdictional encroachments by others: if only a few of the complaints are valid, it would appear that not many countries are being well served by their foreign ministries.

Critics have also noticed that the maintenance of permanent missions abroad costs money. Indeed, the large number of states to which representatives can now be sent, as well as the intergovernmental and non-governmental organizations that require either missions or attendance at meetings, make foreign ministries easy targets for budget-conscious critics. In 1979 the West German foreign service had more than 198 overseas missions, including 124 embassies, 59 consulates general, 7 consulates and 8 missions in international organizations.¹¹ The British government in 1977 had 222 posts,

with U.K.-based staff in 122 countries and 8 international organizations.¹² The figures for comparable countries at the time were 249 for Italy, 177 for Japan, 95 for Australia, and 115 for Canada.¹³ At what point does the cost (in financial terms) of staffing permanent missions in foreign countries outweigh their utility? Should missions be more selectively spread, or concentrated regionally? To what extent should different kinds of embassies be set up where different needs arise (consular, trading, etc.) or should most be miniature versions of the traditional all-purpose mission? Could regular visits by home-based staff become a more cost-effective means of handling relations with some countries? Is dual or multiple accreditation the best strategy? Some critics have claimed to see only waste.¹⁴ But on balance, the expenditures involved in maintaining external representation are not high. The proportion of overall government expenditure in Britain, for example, is around 1 percent.¹⁵

Reviews of foreign services and foreign ministry organization have been a feature of Western countries since the mid-1960s. In some cases the review process has included landmarks in the evolution of thinking about these questions, as was the case in Britain with the Plowden report of 1964, the Duncan report of 1969, and the more critical CPRS review in 1977. Australia underwent several foreign service reviews during the course of the 1970s, most notably in connection with the broader RCAGA process. Reviews of State Department organization and interagency relations have been a U.S. constant during this period.¹⁶ Ireland had a major foreign service review in the 1960s; New Zealand had its Plimmer report on overseas representation in 1978; problems in the Federal Republic of Germany were discussed earlier in the Herwarth report; there have been reviews in the Netherlands of the role of foreign service staff in relation to the public service as a whole; a major review was undertaken by a working group of the Danish foreign ministry and other specialists in public administration in the 1970s; and the question recurs in parliamentary examinations of British government activity, and in in-house government investigations of special topics, such as the Herbecq report on interchange of diplomatic and home civil service staffs in Britain in 1978.

The impulse to engage in these kinds of exercises stems from several sources: concern for the policy implications of inadequately operating consultative mechanisms within and between government departments with foreign policy responsibilities; suspicion that in times of budgetary restraint the foreign policy community is being allowed too easily to claim special exemptions; observation of jurisdictional overlaps, particularly in the economic and commercial policy areas; or, quite simply, distaste for the administrative ethos or *esprit de corps* shared by foreign service officers, or for lines of policy thought to emanate from it.

The review process itself can become a matter of contention. The CPRS investigators in Britain encountered “a widespread reluctance to accept that a further review was needed or that present ways of doing things could

be improved upon.”¹⁷ As one critic of review processes sympathetic to the plight of the Department of Foreign Affairs has pointed out, the problem in Australia was not so much the infliction of several review exercises, as the fact that these constituted together little more than a series of piecemeal investigations.¹⁸ The disorienting consequences of any kind of review can outweigh the putative benefits, but this is perhaps particularly the case with foreign services because of the spirit of informal collegiality within many and because of the sense officers have of participating in a broader diplomatic culture in national capitals around the world. Such notions coexist uneasily with rationalizing administrative or budgetary restraints. Schemes for greater organizational tidiness may be little more than floating solutions, coupled with hazily perceived problems to which they bear little relation.¹⁹ Administrative reorganization has its place, but should not be confused with the process of bringing better *policies* into being. Structural reform, one analyst of the German foreign service has written, is no alibi for policy, and organization no substitute for ideas.²⁰

Why is external representation needed? Tongue in cheek, one 17th-century British ambassador, appreciating that the same word could be used to mean both deceit and the process of sojourning in foreign parts on hard beds, described his profession as being that of “an honest man who is sent to lie abroad for the good of his country.” The intended merriment backfired and, chastened, he later counselled that an ambassador “to be serviceable to his country should always speak the truth.”²¹ The tradition of diplomats attempting to distil in writing the essence of diplomatic method, preferably with a lightly humorous touch and a judicious hint of inner mysteries likely to elude the grasp of the earnest, may now be dead. It survives to the extent that more serious attempts to codify, such as those by Satow and Nicholson, are still read. It does not live comfortably, though, in an age of managerial method, interdepartmental committees, and a more prosaic approach to the agendas of relations between states.

With these agendas increasingly dominated by economic and traditionally “low” issues, the rationale for external representation changes. However, the traditional reasons still apply; it would be what one international lawyer has called an international incivility not to have them and to opt for solitude.²² Nevertheless, the ever more numerous places where some kind of official presence could be justified, and the diverse functions now carried out by large embassies, have significant implications for mission organization. The role of a head of mission may be reduced to the symbolic and ceremonial. The CPRS report identified 14 functions which made up overseas representation: economic, social and environmental work, export services, foreign policy work, defence work, consular services, control of entry into the country, overseas aid, educational and cultural work, external broadcasting, information, political work, communications, entertainment, and accommodation and other administration overseas.²³

In Australia, defence of an active and expanding foreign ministry role could not draw upon a heritage of past practices or of worldwide foreign policy interests. Instead, the Department of Foreign Affairs has directed attention to changing conditions since its founding in 1935:

Why should \$46.5 million of the Australian taxpayers' money go to maintaining 77 overseas missions of the Department of Foreign Affairs? . . . The option of the '30s . . . of making few demands on the world and relying on the protection of Australian interests through identifying them with those of one major power, is no longer available. . . . [Australia] needs a foreign service because it has real interests to pursue overseas and because it must adopt the means to pursue them that other Governments employ. Diplomacy can be seen by some as costly and cumbersome, its rules may sometimes be seen as quaint, but it is the only successful way so far devised to conduct the day to day business of relations between nations. . . . Diplomacy broadly defined is not obsolete. Active international relationships are relied on more and more by nations as the basis on which to advance their interests, and diplomatic activities are the principal means of initiating and furthering these relationships.²⁴

This defence was especially vigorous in part because of the attacks being levelled at the department's "interference" in their affairs by other ministries, and because of public and political antipathy toward foreign service officers.

Debates have thus centred on two broad kinds of administrative and organizational questions. First, to what extent and in what kinds of ways is it desirable or feasible for foreign ministries at home and their officials abroad to pursue a *coordinating* role in relation to the external representation needs of other departments? And second, how should foreign ministry officials situate themselves in relation to *economic and commercial policies*? These questions will be taken up later in this report. But first we must examine the course of institutional change and appraisal in Canada.

Reorganization Issues and Canada's Department of External Affairs

The general question of what to do with foreign ministries has taken different forms in different countries. In Canada the organizational issues are a product of several factors. First, the Department of External Affairs retains some residual flavour of its origins. Its establishment in 1909 predated by 18 years the sending of the first missions abroad, and by 37 years the designating of its own minister, the Secretary of State for External Affairs. The role uncertainty that is characteristic of foreign ministries elsewhere has added force in such circumstances, as it does in Australia. The way the department has evolved in relation to others in Ottawa is

one factor lying behind the “feeling of loss of contact with the mainstream of Canadian concerns and activities” on the part of foreign service officers noted by the McDougall commission in 1981.²⁵

The emergence and structuring of foreign policy issues in Canada has reflected broader political and constitutional contexts. There is a tradition of an active role for the Canadian prime minister not only because of the importance of the matters at hand, as in West Germany, but also because he was the minister responsible for the department’s activities until 1946. It is debatable whether the initiatives of the government led by Pierre Elliott Trudeau in the late 1960s and early 1970s should be seen as a divergence from older norms, or a return to them. In either case, the absence in Canada of a tradition of an unequivocal leading role in foreign affairs by a department led by a strong minister left its mark on debates of the 1970s on government reorganization. It also affected the handling of some of the key foreign policy issues of the period, with the cabinet’s external affairs and national defence committee taking second place on some questions to the priorities and planning committee chaired by the prime minister.

Reappraisals of the role of External Affairs during these years, moreover, took place against a background of wider organizational upheavals in the federal government, as the expansions and experiments of the 1960s gave way slowly to the restraints and restrictions of the 1980s.²⁶ Pressures to reassess practices in the making of foreign policy also arose from changes in the external environment and in the issues facing the foreign policy community: law of the sea, the nuclear trade and questions of nuclear non-proliferation, environmental issues, fisheries, and multilateral trade negotiations. A third source, the requirements of the national economy, became more noticeable and insistent during the formative years of organizational change from 1970 to 1982.

Questions of the internal organization of External Affairs, and of the department’s relations with others, had arisen sporadically during the 1950s and 1960s. Some changes followed the Glassco Commission’s look at government organization in the early 1960s. Not until the following decade, however, did the organization of the foreign service and foreign policy community become more pressing issues, and some words such as integration, unification, consolidation, coordination, and rationalization began to shed meaning as a result of overuse. The immediate origins lay in the events set in motion by the new Trudeau government in the late 1960s. For example, recommendations of the small 1970 Pierce committee, tasked to examine “all Federal Government operations abroad with the view to the maximum degree of integration consistent with effective achievement of government objectives and efficiency in the use of resources,” hinged directly on notions of unification of the foreign service.²⁷ The most significant organizational outcome of the late 1960s debates that culminated in the 1970 white paper *Foreign Policy for Canadians* was the

creation of a new Interdepartmental Committee on External Relations (ICER). Chaired by External's under-secretary, it consisted of the deputy ministers of that department; Industry, Trade and Commerce (IT&C); Manpower and Immigration; and Public Works, together with the secretary to the cabinet, the secretary of the Treasury Board, and the president of the Canadian International Development Agency (CIDA).

While support services of departments operating programs abroad were incorporated into External Affairs in the spring of 1971, no further steps were taken through ICER to bring about greater personnel integration and a unified department.²⁸ Emphasis was placed instead on mechanisms of coordination, and some general principles were agreed upon. For example, it was agreed that policies with external aspects should reflect the combined judgment of the relevant functional and external departments, that External Affairs should be responsible for ensuring external coordination, and that the Privy Council Office (PCO) should be responsible for ensuring that policy proposals were not submitted to cabinet before the coordination process had been undertaken.²⁹

In practice, however, the fact of diverse departmental responsibilities in external relations meant that ICER was not regarded universally as a coordinating mechanism in which External Affairs had the undisputed lead role. Where coordination of a kind did work, it carried with it the risk of so diluting by compromise and negotiation the various departmental positions that ministers in cabinet would have little feel for the real choices facing them. Special coordinating difficulties were posed by differing approaches to issues in Canadian-American relations, a vast canvas in regard to which External's right to a brush and paint could be contested more forcefully by domestic departments.

The reluctance of these departments to accept a lead or managerial role for External Affairs over programs for which they had prior responsibility was also underlined during the McGill enquiries of 1975–76. The focus now returned to the personnel side. On lateral recruitment, for example, a question raised earlier by the Glassco Commission, the McGill report pointed out that the Department of External Affairs made less use of personnel from domestic departments than did foreign ministries in other countries. In line with the trend of reviews in the United Kingdom, it saw this kind of periodic influx and mixing as a constructive instrument in the light of the changing scope of international relations. The handling of missions abroad, though, tended still to be seen as a matter for External Affairs rather than for any coordinating device in Ottawa.³⁰

Further steps in personnel integration were taken in March 1980. This consolidation centred on the move into External Affairs of officers at senior executive levels from IT&C and Employment and Immigration, together with foreign service officers from the latter department and field staff from CIDA. The goal was later described by External's under-secretary as being “to improve the economy and efficiency of foreign operations

without affecting the policy and program development process of the departments involved, to create a single foreign service with a greater sense of cohesion and common purpose, to strengthen the role of heads of post, and to improve the career prospects and broaden the experience of foreign service personnel.”³¹

The Royal Commission on Conditions of Foreign Service (1980–81) acted as a catalyst to take this process of integration a crucial step further. The main problem tackled was the growing sense of malaise among officers of the department, or as then Prime Minister Trudeau introduced the case for greater consolidation, “the dissatisfaction which seems to be prevalent in the foreign service.”³² While much of the commission’s work centred on morale as the dependent variable, it also dealt with two of the major organizational issues to which we will be returning later in this paper. First, the report pointed to an imbalance in the relationship between the Department of External Affairs and its posts abroad. It identified a requirement for a greater measure of post autonomy: “It is essential to let managers manage and make them manage.” Second, and more important, the report recommended that “the process of consolidation be carried to full fruition, including the incorporation of the entire Trade Commissioner Service into the consolidated foreign service. . . .”³³

In the reorganization announced by the prime minister in January 1982, the Trade Commissioner Service and other units of IT&C were finally incorporated into what was signalled as a new department, or a Department of External Affairs with significantly enhanced responsibilities. The changes were billed as the first major step in the implementation of the strategies contained in the document *Economic Development for Canada in the 1980s*, released with the November 1981 budget. The package comprised a reassessment of priorities in areas of domestic regional and industrial development as well as in foreign policy and trade and export promotion. On the latter, more particularly, “Much greater weight will be attached to economic factors in the design of foreign policy and the conduct of our foreign relations, to ensure they serve Canadian trade objectives. Trade matters are becoming a more significant political issue in relations between governments. Canada must therefore speak with a strong, unified voice abroad.”³⁴ Tasks formerly the responsibility of IT&C moved into External Affairs. These included the conduct of bilateral trade negotiations, the administration of export and import controls, and relations with Finance on tariff questions. Responsibility was also added for the Export Development Corporation and the Canadian Commercial Corporation. A realignment of ministerial and senior mandarin roles in the restructured department was announced at the same time.³⁵

The rationale was thus a dual one: to bring together foreign economic and trade functions under the same foreign policy roof, and to link them more coherently within general economic policy processes in Canada. In

addition, more specific arguments in support of the change were advanced by the Department of External Affairs. They included the need to rectify an overemphasis on the secondary manufacturing sector regarded as a failing of the IT&C mechanism; the increasing significance of trading with developing countries, and with those having centrally planned economies; the proliferation of functional issues which needed to be connected more adequately with national foreign policy concerns; and the importance of exports (nearly 31 percent of GNP) for the Canadian economy, and the need for organizational accommodation to this reality.³⁶

Because they touched on matters of direct concern to the business community, the changes and the process of implementation met with more outside interest than is usually the case with government reorganizations. For some critics, the changes represented a continuing and misplaced stress on exports and international trade promotion at the expense of more pressing economic policy priorities.³⁷ There were complaints from the business community that older relationships with government were being cavalierly swept aside; that the procedures and styles of External Affairs were inappropriate either to the promotion of trade or to the cultivation of working relations with the private sector; and that, in such a large, unwieldy and potentially unmanageable bureaucracy, international trade would be unlikely to receive the priority attention it did under the old regime.³⁸ Morale problems resurfaced. Overlaps and duplications in country responsibilities remained. Separation of the trade policy and industrial policy sides also had implications for external relations if decisions in the latter, a domestic area, were too detached in practice from the flow of international events.

This sequence of organizational change in Canada is not complete. Further changes in the internal organizational structure of the Department of External Affairs went into effect in September 1983, with the aim of concentrating responsibility for national or regionally based policies and programs in five main geographical branches. Yet it should not be assumed that the logic and dynamics of organizational change will continue indefinitely to point in the same direction. The underlying issues are intrinsic to the nature of foreign ministries and the organization of foreign policy communities.

In the following sections of this report, we will take up four of these underlying issues for further examination in a comparative context. These are, first, the organization of foreign ministries, including the links between these and missions abroad, and the questions of personnel integration that have a bearing on the making of foreign policy; second, the pursuit of the goal of coordination in a setting of institutional complexity and multiple sectoral foreign policies from domestic departments; third, the organizational issues posed by changing economic and international trade requirements; and finally, problems of recruitment and training in the foreign service.

Foreign Ministry Organization

In most countries, officials of the foreign ministry have shared a distinct administrative subculture of values, style and ethos. Separate recruitment, a hold on appointments abroad, and a major, if not exclusive, say on all matters of policy with international implications, have tended to be the main organizational principles. Separateness in career and promotion terms has been interwoven with separateness in terms of notions of institutional identities and outlooks. The foreign service in Britain may no longer get first call on the cream of university graduates, or rank as high as it once did in external definitions of institutional prestige. However, the more informal collegial working style, in London as well as in overseas missions, retains something of its former force. In foreign service culture in Japan a similar sense of quasi-familial cordiality and solidarity prevails both at headquarters and at overseas posts.³⁹ This kind of working style, some critics have argued, has more defects than strengths; we will return to this point later.

A general trend in Western countries, including Canada, has been toward reduction in the number of services whose members have some kind of foreign affairs responsibilities among their major tasks. In some countries this is primarily of interest only as a historical footnote, but in others the issues involved are still active. A major theme of the Plowden report in Britain in 1963 was the need for a unified diplomatic service. The Foreign Service there was formally established in 1943. Earlier, following a recommendation of a royal commission which reported in 1914, the staff of the Foreign Office and the staff of the Diplomatic Service (those officers serving abroad) had been amalgamated. By 1935 the various consular services (General, Levant, Japan, Siam and China) were amalgamated, at least as far as new entrants were concerned. The change of 1943 thus brought together in one service the staff of the Foreign Office, the Diplomatic Service, the Consular Service, and the Commercial Diplomatic Service. The Commonwealth Service then emerged in 1947 as a result of amalgamation of the Dominions Office and the India Office into the Commonwealth Relations Office. Its staff, however, were administratively members of the Home Civil Service even though they were carrying out activities broadly similar to those of members of the Foreign Service. Similarly, the Trade Commission Service, which emerged in 1946, consisted of officers who as members of the staff of the Board of Trade were also home civil servants.⁴⁰

Fully unified public services tend to be resistant to further change of this kind. In its submission to RCAGA in 1976, the Australian Department of Foreign Affairs proposed not that there should be a separate foreign service, distinct from the Commonwealth Public Service, but only that it should have greater autonomy in the administration of its overseas positions. The conclusion of the royal commission was that government

administration overseas should continue as before to be an extension of the Commonwealth Public Service. Indeed the members of the commission wanted to move in the direction of still greater integration of staffs having domestic and foreign responsibilities. There was criticism of the way in which Foreign Affairs had in practice run its own system of recruitment and training, of the fact that its officers tended to be more confined to one department than any others in the public service as a whole, and that it had tended to allow in recruits primarily at the lowest level.⁴¹

The Plimmer report in New Zealand in 1978, however, recommended among other things that one overseas service be formally established. The Secretary of State for Foreign Affairs should be designated the permanent head of the service. It also proposed that all officers attached to overseas posts should be seconded for the period of their service to the overseas service; and that an interdepartmental monitoring unit be set up within the Ministry of Foreign Affairs to advise and assist the Overseas Service Committee to survey the overall operations of overseas posts, suggest ways in which resources might be deployed more effectively, and undertake continuing evaluation of the objectives, functions and staffing of each overseas post.⁴²

The European practice has tended to elevate the principle of administrative separability. The Netherlands, for example, has retained the older distinctions common in many countries not only between the home and the foreign service, but also between the staff of the foreign ministry at home and the corps of diplomatic service staff sent overseas. Various efforts have been made since the end of World War II to terminate the latter distinction, and to erode the former by encouraging greater interchange and contact between home and the foreign staffs. But traditional practices have been challenged increasingly since the 1960s as a result of the progressive internationalization of domestic policy issues and the rise of sectoral foreign policies run by other departments.⁴³ Similarly, one observer has seen in the specialist training of its own foreign trade experts by the West German foreign ministry the beginnings of a restoration of an earlier bureaucratic *Einheitlichkeitsprinzip* — principle of unity — which had been broken in the period since 1945.⁴⁴ Longer-term trends within the European Community (EC) countries might be working to bring about such administrative consolidation. In Denmark, relations with the EC are primarily a matter for domestic ministries. Dealing with it, in other words, is not a specialized administrative function, but rather an international dimension added on to the primarily domestic functions of civil servants.⁴⁵

An intermediate position is provided by the growing practice of staff interchange between home and foreign civil services as part of a wider process of collaboration between foreign ministries and other departments. The need was recognized in Britain by Plowden. This was more in the context of secondments from the proposed diplomatic service to other

departments, notably the Board of Trade, Treasury and Ministry of Defence. Secondments both to and from the diplomatic service were of great potential value, the report noted, but it emphasized that it did not underestimate the difficulty of arranging them.⁴⁶ The CPRS report of 1977 dealt with the question at greater length.⁴⁷ An interdepartmental working group was set up shortly afterward. This concluded among other things that a further increase in interchange of about a hundred new secondments in each direction, more than double the existing interchange, would be feasible. It also pointed out that the existing practice was imbalanced, in that many more home civil servants were seconded to the diplomatic service than the reverse. In practice, though, the management task would be considerable, and the other costs and burdens on participating departments included a significant public expenditure cost.⁴⁸

Integration thus tends to have certain inherent limits. In many countries, foreign ministry and diplomatic staffs are criticized for being reluctant to be seconded to home departments, or for bristling when staff from them are parachuted into overseas posts.⁴⁹ The other side of the coin is represented in the West German case, where the structural separateness of the profession is an undeniable and irreversible fact.⁵⁰

The way foreign ministries are put together is related to the performance of missions overseas. Receipt of clear instructions enhances the latter; a jumble of policies, issued from different parts of the government machinery, does not enhance performance. One French diplomat, though, has seen good in administrative chaos. The British Foreign Office was “wonderfully organized,” but the Quai d’Orsay “chaotic.” For this reason it was “possible for a member of the British service of moderate attainments to become a successful ambassador, while to be a successful French ambassador a superb intelligence was required.”⁵¹ We can take each end of this link, organization at home and mission organization abroad, in turn.

Foreign ministry organization traditionally presented few problems. The organization reflected the most appropriate geographical division of the world as seen from the national capital. Some changes, to take into account the rise of newer power centres, could be slow to come, but they did not threaten the basic working principle. With the exception of Russia, tight organization of foreign ministries was maintained by the European powers in the period up to World War I. Few great powers employed more than 100 to 150 men in 1914.⁵² By then, however, demands for change from societies as a result of political reforms and industrial and trading expansion were beginning to lead to changes in foreign ministry organization. Governments strengthened commercial departments at home, and improved consular services abroad. Trends toward unified foreign services emerged. Other departments began to challenge the traditional monopolies of foreign offices. Battles for control of the conduct of economic affairs intensified in Europe in the early 1920s. Heads of state engaged in summitry to deal

with postwar problems and the new actors, who were business executives, bankers, and academics, trooped onto the foreign policy stage.⁵³

This longer-term process was still under way in the 1970s and 1980s. In some cases the process of carving out or defending foreign ministry roles has been prolonged and bitter. One of the best documented examples is that of the Australian Department of Foreign Affairs. Historically a late starter in government — the Department's own phrase — it was for much of its life a relatively weak sector in government. Its powers were never clearly defined. Its main concerns were closely limited by other departments, who resisted successfully any attempts by it to play the role of foreign ministries elsewhere. While the diplomatic service itself was more than reputable, the department at Canberra lacked strength as a major policy actor in government.⁵⁴ A determined push for a new role came with the 1970s. This was a time of change in the organization of government generally. The process was assisted by the active search of the government, led by Gough Whitlam, for a more dynamic Department of Foreign Affairs. Other ministers did not necessarily agree, however, and clearly resented what was seen as "an interfering department." The other departments with major foreign affairs responsibilities continued to defend their long-established roles and to argue against attempts to define a coordinating role for the foreign ministry, or for it to take a lead in the political function as far as external relations were concerned. Whitlam himself referred at one point to the "fury with which federal departments fight for their preserves." Yet the Foreign Affairs department had some successes. Law of the sea questions, for example, represented a newly emerging set of issues on which no other department had a clearly established expertise. In taking the lead in this area, Foreign Affairs successfully broke the claim of the attorney general to be the legal counsel for all Australian government departments.⁵⁵

In moving away from traditional geographical organization, and in coping with outside competitors, have foreign ministries taken on too many tasks? Could many be better managed by functional ministries? One Japanese observer has argued that foreign offices should resist the temptation to take on additional functions on the grounds that their roles are to plan and coordinate.⁵⁶ The Duncan report raised the question of overstaffing in the British Foreign Office, comparing numbers of senior officials at the same level there with those in the Treasury or Board of Trade. A defence of this relatively high number, it recognized, was that political staff at home enabled the diplomatic service to do in London work which would otherwise have to be done at greater expense abroad. But there was risk of duplication and circularity. "The political officers in the chancery at Strelsau and the Ruritanian desk officers in the Foreign and Commonwealth Office may make more work for each other than the intrinsic importance of Anglo-Ruritanian political relations really justifies; and this

tendency will only be increased by the likelihood that each group contains able and energetic men who will not be content to produce less than a full day's work." Similarly, MPs and others could make non-essential enquiries because they had found the FCO well informed in the past, and the FCO "may wish to go on amassing non-essential information because they have grown used to enquiries of this kind."⁵⁷ Work habits die hard. Translation of this kind of circularity into non-political areas as a result of foreign ministries developing their own bodies of specialists in many different policy fields would be a costly trend; and the newer areas are precisely those which are more fertile creators of domestic clients and constituencies.

In 1977, at the time of the CPRS review in Britain, the FCO had seven functional departments: Financial Relations, Trade Relations and Exports, Energy, Maritime and General, Science and Technology, European Integration (External) and European Integration (Internal); there were also United Nations, and Arms Control and Disarmament departments, together with a group of government Economic Service economists working in the FCO.⁵⁸ Some domestic departments charged that the FCO was duplicating, or even usurping, their functions in the analysis and assessment of information, in advising ministers collectively and in carrying out policy. The CPRS conclusions were correspondingly critical:

We think that home departments should as a rule take the lead in the overseas aspects of their domestic concerns. We also think that there has been some tendency for the FCO to be unnecessarily active in areas of home departments' responsibility. The tendency has perhaps been most noticeable in areas where the home department is newly formed or lacks international experience — perhaps because an issue has only recently acquired a major international dimension.⁵⁹

It was acknowledged that there was a need for the FCO to have its own sources of in-house advice on economic topics and on others falling primarily within the responsibilities of home departments. But it was suggested that when a topic wanes in importance, then the resources of the FCO's functional departments devoted to it should also be diminished. The Department of Energy, for example, was just coming into existence at the time of the 1973–74 oil crisis; by the late 1970s, it was thought that the resources still being put into this question by the FCO probably exceeded what was necessary. In sum, there was a risk that the FCO's capability would "exceed what is necessary for appreciating the issues and advising the Foreign and Commonwealth Secretary" or that the capability would "not be adjusted to changing circumstances."⁶⁰

Foreign ministries have also had to fight to protect turf abroad. Their degree of success may sometimes be inversely proportional to the size and importance of a particular mission. Super-missions, such as those in Washington, operate as sub-branches of government abroad. As miniature

replicas of the various government departments at home, they raise again the problem of coordination and the role of the foreign ministry. It could be generally accepted that, for a Western country, the embassy in Washington should rank first in terms of size, prestige and resources. It is less easy to discriminate between other countries, beyond a few relatively straightforward cases. Investment in real estate and the risk of giving offence are among factors which in practice reinforce maintenance of previous positions abroad rather than allowing them to slip downward or into oblivion with the passage of time. For some countries, dual or multiple accreditation may be an option; a common enough practice, this has nonetheless tended to be frowned upon among the older foreign ministries.

Just as difficult is the question of the organizational make-up of the mission. The approach of the Duncan report in Britain was to define a broad geographical area, or area of concentration, within which comprehensive representation would be needed for the indefinite future. The countries were those of western Europe and North America. The issue was not so much one of size as of the type of representation to be maintained in different countries: "The Embassy in San José is naturally much smaller than the Embassy in Washington; but it is still essentially an animal of the same species."⁶¹ The CPRS report later took the principle of post specialization still further.

Variety in overseas missions was already a feature of Australian external representation in the 1970s. The issue posed then was how far to press forward with or to reverse the trend. The number of overseas posts had grown rapidly in the 1960s and 1970s. The total in late 1975 was 94, consisting of 66 full diplomatic missions (including 4 missions to international organizations), and 32 functional (non-diplomatic) posts, of which 7 were in countries where there was no mission. Further, the head of 23 of the 32 functional posts was an officer from a department other than Foreign Affairs (either Overseas Trade or Immigration and Ethnic Affairs). This, the RCAGA report noted, "indicates a commendable flexibility in organization overseas."⁶² It recommended:

. . . that new missions or posts be opened only when there is a clear need; that the structure of a post be determined by direct reference to its main functions; and that regular reviews be made of the need to maintain missions or posts. . . . Where the functions are primarily related to those of a department other than Foreign Affairs — normally these would relate to trade or immigration — there should be no automatic assumption that the post should be headed by a Foreign Affairs officer, though a specialist Foreign Affairs officer might often be attached to the post for "political" functions such as reporting.⁶³

The circumstances of Britain and Australia in this matter were, of course, somewhat different. Issues of size and function were approached in one from a position of retrenchment from widespread overseas interests, and

in the other from a historical position of minimal involvement in the traditional foreign policy areas. Similar kinds of arguments, however, with an eye to budgetary restraint and foreign exchange costs, were put in Britain in the CPRS report. It recommended "that geographical variations in requirements [for overseas representation] should be monitored continuously and, in functional areas where rapid changes are taking place, the means of meeting the requirements should be very flexible."⁶⁴ Questions were raised about the possibility of over-staffing in relation to North America and in both cases the number of residents seemed high relative to visits; if the number of resident staff were reduced to the point where visiting capability was 50 percent instead of only 30 to 40 percent of resident capability, the report maintained, then six person-years in North America and five in non-EC western Europe could be saved.⁶⁵ Some posts needed special kinds of expertise: civil aviation in Hong Kong, or agriculture in Washington, Paris, Bonn and South America.⁶⁶

With variation in function comes variation in the department from which comes overseas staff. This leads to the question of whether the head of mission, if a foreign ministry official in a traditionally organized post, is the *de facto* executive head, or whether, in the absence of a particularly forceful and determined head of mission, the tendency is for this to become what one American observer has called a polite fiction.⁶⁷ The capacity of interdepartmental relationships at home to generate conflict abroad was confronted by RCAGA in Australia in the mid-1970s. It recognized that most departments, when sending officers overseas, needed to keep in touch with them.

They want the officer to be used for the purpose for which he was sent, and in the country to which he was sent, and require that he be answerable to his own department in matters of function. It would be unrealistic to believe that any officer who was posted abroad for even three years could in fact cut himself off from the parent department in which his future career lay.

There could therefore be

. . . occasions of conflict between the Foreign Affairs activities at a mission and those of an attached officer from another department. In theory this should not be possible because of co-ordination of policy in Canberra, but it is not likely that in the foreseeable future co-ordination will reach that point of perfection.⁶⁸

Coordination and the Management of Complexity

The classical mode of diplomacy discussed earlier in this report may never have existed in anything resembling a pure form. Even a substantially qualified version, however, contrasts sharply with the realities of government in the late 20th century. Complexity, in the guise of a proliferation of

issues, the spread of governmental and public actors, and apparent loss of direction, points in the direction of the need for different forms of management and administration in the overlapping and tortuously interwoven areas of foreign and domestic policy. Yet there is also a near-universal sense that attempts to remedy resulting problems, usually classed under some “coordinating” label, work only feebly at best and at worst may compound the problem.

The problem is not a new one. As we saw in the last section, the emergence of new governmental actors playing a part in foreign affairs, traditionally home departments testing their muscle in the international arena, are factors in the period from the 1920s on. Even before World War I one diplomat found muddle, confusion and chaos in foreign policy organization in Berlin.⁶⁹ The rise of international organizations in functional areas has added to these problems. The European states which joined the European Community have experienced complexity in an acute form. Meetings in the main EC and member state capitals have, apart from giving work to companies specializing in the mass shipment of papers, created a large external extension of the normal workings of government. The obligation to consult with counterparts in other member states has greatly increased the number and the variety of government departments in each country which pursue their own foreign policies. The problems of foreign policy complexity and coordination are “wicked ones”: they do not merely defy solution, but satisfactory definition, too.⁷⁰

Sectoral foreign policies have not usually challenged the domination of the external representation function by diplomatic services. In Australia in the mid-1970s, more than three-quarters of those serving the Australian government overseas were attached to the Department of Foreign Affairs: 731 out of 1,200 permanent officers, together with 2,700 in the related administrative category of “exempt” employees. The other largest departmental employers of staff overseas were Labour and Immigration (186 permanent officers) and Defence (1,285 exempt employees); a further 128 official were employed under the Trade Commissioner Act.⁷¹ For EC member states, however, the position is complicated by the participation of domestic ministry officials in meetings of Community committees. Some of these departments make use of the traditional attaché system as a means of obtaining direct access to missions. Denmark, for example, had a total of 47 specialist attachés posted abroad in 1979, coming from a wide variety of departments: Agriculture, Fisheries, Trade, Defence, Budget, the Economic Secretariat, the National Bank, Public Works and Social Policy, and Justice.⁷²

Whether or not this option is available to domestic departments, the foreign policy community generally has to accommodate the problems associated with the rise of such sectoral foreign policies. The Netherlands is a case in point. The main economic institutions involved are the Ministry of Economic Affairs, particularly its Directorate-General for Foreign

Economic Relations (BEB), and the Ministry of Finance. As in all EC member states, Community policies have made the agriculture ministry, which also has responsibility for fisheries, one of the most internationalized sectors of government. And because of the economic openness of Dutch society and participation by the Netherlands in many international organizations, other departments also enter the general picture: Education and Science, Justice, Cultural Affairs, Recreation and Social Work, and Public Health and the Environment. Historically, the Department of Economic Affairs and the former Department of Overseas Territories often handled important economic negotiations themselves; and for years, both the foreign and the economics ministers claimed the right to coordinate foreign economic policy.⁷³ In the Dutch case, bureaucratic competition has been reinforced by political arrangements. Because of coalition making among many competing political parties, the heads of key ministries with foreign affairs responsibilities, such as Foreign, Economic and Defence, more often than not have belonged to different parties.

Domestic economic bureaucracies thus put major constraints on the freedom of manoeuvre of foreign ministries. A former Treasury official in Australia has put it succinctly: "Is there a Treasury view? Yes, it is 'No'."⁷⁴ Of foreign ministries in countries belonging to the Organization for Economic Cooperation and Development (OECD), that of Japan is perhaps in the least enviable position in this respect. The major segments of the economic bureaucracy operate relatively autonomously. This is particularly true of the Ministry of International Trade and Industry (MITI). But five other bodies also have important international economic responsibilities: the ministries of Finance, Agriculture and Forestry, Transportation, and Construction, together with the Economic Planning Agency. MITI has been especially successful at protecting its domain. International trade has been closest to its mandate, and that most jealously guarded from other ministries. This was only one of five areas defined for it originally, together with domestic areas such as industrial rationalization, enlargement of productive capacity, nurturing of medium and smaller enterprises, and development of industrial technology. In international monetary policy, too, MITI, together with the Economic Planning Agency, has inputs of substance even though this is primarily the area of the Finance ministry. Japan lacks a coordinating body authorized to reconcile differences of viewpoint among ministries. Each is thus able to defend successfully its own *nawabari* (sphere of influence); indeed, members of different ministries each develop a marked *nawabari ishiki* (territorial consciousness), a reflection of interministerial rivalry that has always been pronounced in Japan.⁷⁵

In the Federal Republic of Germany, defence of the free market principle in international relations has been central to the conduct of foreign policy. As such, the key players have been not so much the foreign ministry as the finance ministry and the economics ministry. The finance ministry

(BMF) in Bonn has substantial influence over trade policies, international finance and capital movements questions, and in relation to several key sectors of the policies of the European Community. One section in particular (Abteilung V) has leading and supervisory responsibilities in relation to EC policies as well as on international financial questions generally. These functions are shared with the economics ministry, which was closely involved in international seabed negotiations, those related to the General Agreement on Tariffs and Trade (GATT) and sessions of the United Nations Conference on Trade and Development (UNCTAD).⁷⁶

Points of interdepartmental conflict may become points of potential collaboration by indicating policy areas where sectoral autonomy will not work. Most Western countries have experimented with various kinds of coordinating mechanisms. Foreign ministries are not, of course, the only departments of government which could take on a coordinating role, as competition in the Netherlands for this job indicates. They have laid claim to this right, however, on the grounds that coherence among diverse sectoral foreign policies is desirable and that no other department has the resources or trans-sectoral perspective equal to the task. The kind of coordinating mechanism aspired to, however, depends on the historical location of the foreign ministry in the governmental structure. A traditionally prestigious and powerful one approaches other departments in a different way than one traditionally seen as secondary to the workings of line departments. In the latter case, as in Australia, foreign ministry approaches to the coordination function have often masked only slightly the pursuit of a far more important role in government.

The historical process of being slowly pushed onto the defensive began for the Foreign Office in Britain shortly after World War I, with reparations and other economic matters increasingly dominating international agendas. By the 1960s, the need for cooperation with the main domestic departments, and the related requirement of the Foreign Office acquiring and cultivating its own sources of specialist expertise, had become widely accepted.⁷⁷ It was assumed to be self-evident that it was indeed the Foreign Office that had final responsibility in the overseas field. Some aspects of the coordination problem were later removed, or at least changed from an external to an internal problem, with the institutional amalgamation that led to the creation of the Foreign and Commonwealth Office (FCO). There was little support, though, as we have seen, for the principle of a fully integrated civil service comprising both home and foreign staffs.⁷⁸ Unification might by implication weaken the capacity of a distinct group of civil servants, operating out of one department, to exercise a broad harmonizing and coordinating role. A separate service implies a distinct set of roles within government, clearly definable areas of expertise, recognition of different recruitment needs, and an integrated view of the international arena that cannot be achieved by domestic civil servants. Some of the assumptions were challenged in the CPRS report. In relation to “foreign policy work”

the FCO took the lead on almost all issues, and it was “correct that it should do so.” Coordination with the defence ministry (for example on matters such as NATO, Berlin, the Mutual and Balanced Force Reductions talks (MBFR), disarmament, security of dependent territories, or defence relations with politically sensitive countries) generally seemed to be “effective and economical; both show proper but not excessive concern for the other’s interest.” Export requirements, however, suggested the advisability of solving complex coordination problems by the creation of a new institution. This would draw in sections of existing mechanisms such as the Export Services and Promotions divisions of the Department of Trade, and part of the Trade Relations and Exports department of the FCO.⁷⁹

Interdepartmental committees in the foreign affairs field have been both used and reviewed extensively in Australia. There has been much resistance by traditionally strong home departments to a growing assertiveness on the part of Foreign Affairs. The social unrepresentativeness of Foreign Affairs officers and the administration of what seemed to amount to a closed shop reinforced these criticisms. Foreign Affairs officers could not “legitimately exercise wide coordinating powers when they have had so little experience of other departments.”⁸⁰ Interdepartmental coordinating mechanisms led from this department, then, were all the more likely to be perceived as unwarranted interference in the internal affairs of others. Domestic departments responded by maintaining that the role of Foreign Affairs was a residual one, and frequently labelled it the “political function.”⁸¹ This applied particularly, in the views of officials of the economic bureaucracies in Canberra, to the international economic field. Foreign Affairs was simply not an appropriate coordinating department where economic as well as political issues were of major importance.⁸²

At least until the late 1960s, for example, it was not Foreign Affairs but rather Trade and Industry that took the lead in Australia’s bilateral relationship with Japan. A diplomat of the period has commented on this department’s unique position, which was the result in part of the political strength of its minister. “In effect it rated with Treasury well above Foreign Affairs. It was well known in Canberra that no cabinet minister would risk a dissension with or over the Trade department.” In one much-publicized incident, the ambassador to Japan was not even informed of details of an important Australia-Japan trade agreement being negotiated there by trade officials in 1957 until the text was suddenly telegraphed to him.⁸³

In the 1970s the dogged pursuit by Foreign Affairs of a coordinating role led to its presence on a significant number of interdepartmental committees (IDCs). In 1975 it was represented on 49, far short of Treasury (108) but respectably comparable with Manufacturing Industry (55). It was the convening department for 13 IDCs, behind only Defence (22).⁸⁴ The experience led to considerable criticism. First, Foreign Affairs officers themselves regretted the time and energy and dispersal of thin resources

that had to be devoted to interdepartmental committee tasks. Slowness of consultative operations worked to Foreign Affairs' disadvantage. Second, defence of entrenched departmental positions seemed the normal feature of IDC workings. These became forums for disputes previously contested elsewhere, rather than for constructive consultation and contact. Third, the motivations of most departments in seeking roles on consultative bodies of this sort, especially leading and initiating ones, were often all too visible. Foreign Affairs wanted a role for itself in government more comparable with that of foreign ministries in countries with longer diplomatic traditions. The RCAGA report found some aspects questionable: Foreign Affairs should "resist the temptation to elevate in an exaggerated way international political elements to justify its own intervention. Such a practice, of which several departments complained, tends to undermine the confidence of departments in the advice of the Department of Foreign Affairs and to reduce their willingness to consult it."⁸⁵ Finally, the department was clearly dependent on resources of information and expertise lying within other departments of government, and lacked domestic constituencies. Both factors seriously limited its capacity to coordinate.

Development of the specialized expertise that might be a precursor to foreign ministries acting as coordinators has recently become more prevalent in Western countries. Clearer demarcation of political and economic functions and development of the latter was proposed by the interministerial working group on foreign ministry reorganization in Denmark in 1979.⁸⁶ The 1969 Devlin report in Ireland referred to the "urgent need to strengthen the economic role" of the Department of External Affairs; there was a need for a "total trade policy" at home and abroad. It accordingly recommended that responsibility for trade be coordinated by and concentrated within the department, which would thus oversee related activities by the departments of Finance, Agriculture, and Industry and Commerce, as well as the Irish Export Board. The recommendation was made in the light of the traditionally weak position of the department's foreign trade section. Its economic division later handled such questions as participation in OECD, GATT issues, and foreign trade policy generally.⁸⁷ West Germany's foreign ministry has similarly taken on responsibilities in relation to foreign economic policy,⁸⁸ but for reasons already noted it has lacked the authority of the Irish ministry within its own sphere.

Not all foreign ministries or observers have argued along these lines. One student of the Japanese foreign policy community has argued in favour of the handing over of functions to other agencies of government. This was preferable to the foreign ministry's development of its own specialists, and allowed it instead to play the role of overall synthesizer. The risk, that its functions would become progressively more truncated, he was prepared to accept since, in his view, the foreign ministry should be operating more on a staff than a line basis — planning policy rather than merely executing it.⁸⁹

Could foreign policy be coordinated in other ways? One answer, obviously, is yes: at cabinet level. Heads of government are increasingly compelled to be interested in international affairs. Many have experimented with staffs having broad information, policy recommendation, or coordination functions. This last has been assumed at intervals by the Prime Minister's Department in Australia since the early 1970s. In West Germany, Konrad Adenauer's early chancellorship (1949–55) was marked by such high-level coordination. Chancellor Willy Brandt later (1969–72) used high-profile political figures in his office with the same aim in view. A division of that office which deals specifically with foreign policy has supported the chancellor's key role on interministerial coordinating committees on the economy and on defence, and on the cabinet's European policy committee.⁹⁰ European Community membership has given particular force to the requirement for more effective coordination. This is true especially of the rotating six-month periods during which each member state assumes the presidency, i.e., chairmanship of the Council of Ministers. In Denmark, this machinery is reinforced by the tight parliamentary control exerted through the parliamentary committee on EC affairs.⁹¹

Second, coordination of a kind may be a product of a common administrative culture shared by senior officials in different departments. One West German critic has written that the faults of the foreign service are the products of more general German political, social and administrative traditions.⁹² This kind of observation has been made frequently in relation to British government. But mandarins are not necessarily, or consistently, united. Some departments are more equal than others. It has been suggested that Treasury officials in Britain, as part of their more intangible instruments of control, make use of just such notions of a common higher administrative culture for their own purposes.⁹³ Third, not only foreign ministries claim coordinators' rights. In the Netherlands, both the Foreign Ministry and the Economic Affairs ministry have historically regarded themselves in this light. Of interdepartmental committees in West Germany, that in the key area of foreign trade is run out of the Ministry of Economics.⁹⁴ Finally, conflict has led some review bodies to recommend the creation of new ministries. The RCAGA in Australia considered, but finally rejected, the idea that all international activities should be grouped together within a new mega-department with far-reaching coordinating powers in the foreign affairs field.⁹⁵ The Duncan report recognized the promotion of exports as a high priority for Britain's overseas services, and the CPRS report in 1977 went on to recommend the establishment of a new department concerned wholly with export services.⁹⁶

External Representation and the Economy

The traditional competences of foreign ministries have been tested most in relation to the economy, because there has been no clear administrative

or policy-making model to clarify the most appropriate roles for foreign ministries in relation to national economies. On trade questions, moreover, the expectations of individuals and organizations outside government are important; in mixed economies, governments are inherently limited in their persuasive capabilities vis-à-vis the private sector. In broad areas of international economic or monetary policy, foreign ministries have often been relegated to the second order among government departments. In relation to some of the newer issues on the international economic agenda, such as fisheries, energy, and law of the sea, some foreign ministries have been able to take a lead; and do so on the basis of the relatively weaker international arms of the domestic ministries which have traditionally handled such questions.

At least three possible roles for foreign ministries in relation to the economy can be defined. First, the foreign ministry can take the lead in key areas. This has been most successfully attempted in relation to newly emerging issues such as law of the sea. In more traditionally defined economic policy areas foreign ministries tend to be the encroachers. When commercial questions were inherently of a lower priority, this was less disturbing to the position and authority of the foreign ministry. The British practice in Commonwealth countries, for example, was traditionally for commercial work by overseas missions to be allocated not to the diplomatic service but rather to officials of the appropriate domestic trade ministry. This kind of divided control was generally thought non-viable as a working principle for overseas missions.⁹⁷

More common in practice is a second role: acting in various secondary capacities with the initiative and definitions of objectives and operating rules being taken elsewhere. Australia followed this pattern until the beginning of the attempted changes which started in the late 1960s. In Japan the foreign ministry has remained a respectful distance behind MITI in the international trade area. Appreciation of such trends was a powerful motivator for foreign ministries; officials could decry their lack of expertise on economic matters, and perceive in its acquisition the key to regaining of lost ground. The third role is more ambiguous and resistant to precise definition: coordination and interdepartmental collaboration in foreign economic and commercial policy areas.

Before looking at government organization we must review the private sector needs met by, and the demands placed on, government. In a former age the relation between the overseas trader and government was simpler. The successful pursuit of trade required stability in political conditions. As the 17th-century Dutch statesman Johan deWitt expressed it: "The interest of the State demands that there be quiet and peace everywhere and that commerce can be conducted in an unrestricted way."⁹⁸ Australia's geographical isolation makes external representation especially important.⁹⁹ But few business executives today rush to the defence of more active government roles abroad: officials may be held to have failed

to serve their needs, or to have displayed a regrettable predilection for interfering in the marketplace. Foreign ministries for their part will readily admit to deficiencies in their relations with the private sector. Resistance to government activities is marked in some countries. Trade promotion in West Germany is overwhelmingly a private sector task. Nowhere can bureaucracies compel firms to move into new markets. Attempts by governments outside the centrally planned economies of the socialist states to foster international cooperation by trade are heavily dependent on the goodwill and definitions of economic self-interest of firms.

A change in attitudes on the part of foreign service officials was advocated in Britain in the 1960s and early 1970s. The problem was partly the result of a traditional decrying of the commercial ethic among entrants to the civil service. Greater specialization had been an acknowledged goal since the Fulton report on the home civil service in the 1960s. The Duncan report noted that there had been considerable improvement in the commercial performance of the diplomatic service, but much remained to be done. More particularly, commercial staff did not always talk the language of business.¹⁰⁰ As one solution, the CPRS report proposed taking businessmen into the reorganized government structure and giving them responsibility for exports; the ideal candidate was the risk-averse, organizationally minded business executive. Export officials, it said, should think more like businessmen if they are to be more accessible, responsive and credible to exporters. What was required was a change of attitude.¹⁰¹

It is generally accepted that the lead and the definitions of requirements lie with the private sector. This is particularly the case in West Germany. Business executives travelling abroad, not officials, get export orders. A recurrent theme of the CPRS report in Britain was the danger of too much government involvement. In the developed world, the government was devoting an unjustifiably high volume of resources to overseas representation. There was a role for government, especially in relation to eastern Europe and the Third World. But "much of the difficulty about accessibility, responsiveness and credibility arises because it is the Government, with its bureaucratic organization, language, lack of emphasis on expertise, and image, which is providing the services."¹⁰²

Much attention has been paid in reviews to government-industry collaboration in overseas markets. From a government's point of view, the appropriate services here are still at base the traditional ones: contacts and local knowledge. There is also the task of persuasion, of responding to private sector enquiries and getting business executives into new regions. But governments might thereby be simply duplicating services firms can readily provide for themselves, especially larger companies adequately equipped with their own market analysis teams. Moreover, exports to overseas affiliates and to other divisions of the same multinational corporation amounted to more than 30 percent of U.K. exports of goods in the mid-1970s; this kind of trade does not depend on government export promotion services.¹⁰³

One collaborative model was defined in the so-called Milan Concordat. This informal agreement between commercial counsellors in British posts in European countries and British Chambers of Commerce acting in the same countries outlined in broad terms their respective areas of work. There have been various proposals for active collaboration between government and industry going beyond this because (except for West German business organizations) chambers of commerce and other representative bodies acting alone tend to be constrained by thinly spread resources and the basic fact of competition between firms.

Lack of economic expertise has been a complaint frequently directed against foreign ministries,¹⁰⁴ but the broad question of specialization versus retention of generalists is one that will persist as long as governments exist. Concerns about overemphasizing the requirement for specialist skills are grounded in three factors. First, it runs counter to a long tradition in foreign services. Proponents of this tradition maintain that specialists can undermine the cohesion, ethos, sense of community, and ease of communication that are crucial to the successful workings of foreign ministry staffs. Specialization beyond the traditional requirements of language and area knowledge should be approached with caution, they say, because what is needed is the first-rate mind which can be turned to a succession of different questions. Second, an emphasis on specialization might conflict with the need for overseas missions to engage in political work involving analyses of complex situations. Third, too much emphasis on specialized knowledge may conflict with effective performance of the coordination function.¹⁰⁵ Britain's Duncan report, for example, stated that advanced economic skills were not a condition for effective economic reporting; what was needed was a generalist who had sufficient training in basic economic concepts to be able to handle such material intelligently.¹⁰⁶ One of the recommendations of the earlier Plowden report, which acknowledged that the foreign service had already moved substantially away from the generalist stance of the 1943 changes, was that officers should spend at least half of their careers in their region or subject of specialization.

As the Canadian experience has shown, however, the organization of the relationship in government between foreign service officers and specialized international trade staffs does not lend itself to easy solutions. The general trend in the direction of greater administrative integration has already been noted. The RCAGA in Australia, for example, tended to support the argument put by the Department of Foreign Affairs "that the real problem is not so much that the Department fails to give sufficient weight to economic considerations in formulating foreign policy, as that specialist departments have a natural tendency to overlook other Australian national interests for which they have no responsibility."¹⁰⁷ As applied to overseas commercial work, this meant an overseeing role by generalist officers of the Department of Foreign Affairs.

In Australia the commercial function has traditionally been distinct.

The Trade Commissioner Service was established under separate legislation passed in 1933. At the end of June 1975, 128 Australians and a total of 483 locally engaged staff held appointments under the Trade Commissioners Act. In addition, 75 officers were then serving abroad from the Department of Overseas Trade, who in terms of regulation of work fell under the general conditions of the Public Service Act applying to civil servants in home departments. Trade commissioners acted as integral parts of the mission abroad, using the same transport, communications, general accounting and other services, but they maintained personnel establishments and budgets separate from those of the Department of Foreign Affairs. The consultant's report which reviewed these and other matters came to the conclusion that, though the specific legislation was no longer needed, the service itself was. The act's existence was "not necessary to ensure the continuance of that Service and the repeal of the Act should be done in conjunction with the introduction of arrangements for the effective continued operation of the Trade Commissioner Service."¹⁰⁸

The record in Britain is more complicated. Export promotion and overseas commercial work generally was left to the private sector before World War I. This tradition continued into the interwar years. Pressure for change then tended to come from companies operating overseas who argued that they needed support services similar to those being increasingly provided by other countries.¹⁰⁹ The Foreign Office had had its own commercial department since 1866, though it was several more years before the practice of appointing commercial attachés to the larger embassies became established. A Department of Overseas Trade was set up at the end of World War I but was abolished in 1946; the consensus was that integration was preferable to cleavage into too many subdepartments.¹¹⁰ From then on, all commercial work in foreign countries was entrusted to officers of the Diplomatic Service. Postings, however, were cleared with the Board of Trade, and it was to this body that these officers did most of their reporting. Before 1965, a separate arrangement was also in place as far as Commonwealth countries were concerned: high commissions were controlled by the Commonwealth Relations Office, but trade commissioners fell under the Board of Trade, a bifurcation that prompted criticism.

In the Netherlands, the foreign ministry has since 1946 faced an especially powerful division of the Ministry of Economic Affairs, one designed to have broad responsibilities in relation to foreign economic relations and to exercise an overall coordinating function in relation to all departments with overlapping areas of competence in this general field.¹¹¹ This has naturally led to conflicts. Both ministries have been able to point to legitimate grounds for exercising coordination tasks. The confusion was resolved partially in 1972 when the Council of Ministers decided that henceforth the Ministry of Foreign Affairs should have responsibility for the formation of a coordinated policy on matters regarding the EC, as well as for a coordinated execution of this policy.¹¹²

Ministries with functions in the trade field, as distinct from broader matters of economic policy, have in general been more amenable in practice to overall coordination by foreign missions. In Britain there has been a gradual drawing in of officers and departmental functions under the aegis primarily of the Foreign and Commonwealth Office. A similar tendency is apparent in Australia, though conflicts between the trade and the “political” side of missions abroad have been more problematic there.

A more radical integration proposal was made by the CPRS in 1977. It concluded that the importance to the United Kingdom of commercial and export promotion work was such that a new department was needed to oversee all government activity in this and closely related areas. The proposal arose out of consideration of the proliferation of government bodies having input into this area. These included the Export Credits Guarantee Department (ECGD), which provided export credit insurance; the FCO itself, which operated most of the overseas end of the export promotion services; and the Department of Trade, which operated most of the home end. In addition, private bodies acted in conjunction with government. The British Overseas Trade Board (BOTB) was set up in 1972. It consisted of both business executives and representatives of the departments mentioned (together with the Department of Industry), and had a secretariat of civil servants in the Department of Trade. A British Overseas Trade Advisory Council (BOTAC) was set up in 1975 under the chairmanship of the Secretary of State for Trade with the intention of allowing a wider range of exporting interests to discuss export promotion and related questions. The variety of functions carried out by these institutions included overseas publicity for the export promotion services, trade fairs and promotions, outward missions, assistance to non-official trade organization overseas, handling enquiries from overseas, and joint commissions.¹¹³ This untidy sprawl, in the CPRS view, needed welding together into a much more effective and centrally controlled instrument.

Despite this kind of organizational complexity, and the multiplicity of varied activities of government involved, the objective here is reasonably well defined: promoting exports, and finding the most efficient means of doing it. Foreign ministries have a key role since they traditionally have control of the external representation function and the staffing of missions overseas. The position is less clear for broader areas of foreign economic policy.

For member states of the EC, this term now embraces a considerable variety of domestic policy concerns. In the case of Britain, the FCO in this broad area has retained the lion’s share of representation overseas (146 person-years out of a total of 204 in 1975–76). But staff resident in the United Kingdom with responsibilities for overseas economic work came predominantly from domestic departments: the FCO share was 185 person-years, as opposed to 560 for the Department of Trade, 185 for the Department of Industry, 280 for the Bank of England, 140 for the Ministry of

Agriculture, Fisheries and Food, 125 for the Department of Health and Social Security — a total of 1,880 for 1975–76.¹¹⁴ The FCO was thus in a minority position in London in relation to the total resources of government manpower devoted to overseas economic work. The diverse activities involved were domestic policy areas affected by international factors (e.g., agriculture in the context of the EC); multilateral economic work (e.g., economic summits, the GATT, the EC, North-South dialogues and forums, international organizations with either regulatory or consultative functions); and bilateral economic work (including bilateral matters of trade promotion and exports).

In these kinds of areas, vast amounts of information are needed on a continuing basis. This requirement affects the changing nature of the functions of overseas missions. As a general rule these missions cannot act as a government's only, or even primary, source of foreign economic intelligence. The CPRS, for example, argued that posts overseas were to be seen as useful rather for filling gaps in information at home. This was particularly so in times of rapid economic change, or in the context of a series of closely spaced discussions at which the British government needed to be continuously updated in its knowledge. Two criteria, it suggested, governed the utility of reports from overseas posts in these circumstances: the timeliness of reporting, both in the speed and in the certainty that it will arrive as requested; and the gloss that officials abroad were able to put on facts, by setting economic developments in their political context and by assessing foreigners' intentions where possible.¹¹⁵ The other side of the picture is organization at home. If staff reporting from abroad significantly outnumber staff on the receiving end — there have been a number of attempts to define the ideal proportion — then reports may go unread, or those studied may not be acted upon.

Foreign economic policy, then, is likely to be characterized by conflicts within and between various government departments. Denial of this may be internalized by officials in some countries, as well as required form in dealing with outside investigators. Japanese foreign ministry officials interviewed by one researcher reacted negatively to queries about possible disputes and conflicts among them.¹¹⁶ The obstacles encountered by some foreign ministries in relation to economic issues are a product of the traditional strengths of the economic or finance ministries, and a long-standing and equivocal approach by most foreign ministries to questions of their own requirements for expertise in these areas. Reviews of the overall machinery in government for handling international economic issues, however, have been few compared with those dealing specifically with foreign services and foreign ministry organization. The gap is an unfortunate one. It limits the usefulness of the latter type of review exercise, since foreign ministries cannot be viewed in isolation from the rest of government, and also constrains the emergence of a potentially more productive debate

on the national mechanisms and processes appropriate for dealing with the interdependent Western and global economies.

Recruitment and Training

We have so far raised issues relating to the organization of foreign ministries in the light of the changing character of external representation, approaches to the problems posed by the growing complexity of the international environment and its links with domestic policies, and the implications for government organization of international trade and economic questions. To what extent do changing requirements put demands on the resources of expertise of foreign ministry personnel?

Criticism of either the narrow social class or educational recruiting base of foreign service personnel in Western countries has a long heritage. Before 1940 the Dutch foreign ministry had only 60 professional staff members and 80 in the foreign service and, as a largely aristocratic body, was generally unpopular.¹¹⁷ Bias of the second kind has been prevalent in the Japanese foreign service. Apart from other educational qualifications, two-thirds of the 310 high officials of the Japanese foreign ministry in 1970 were graduates from the law faculty at Tokyo University. About 80 percent in the next category of civil servants in the ministry were also graduates from this school, and there was a high correlation between graduation from this institution and the speed of promotions after entry into the foreign service.¹¹⁸ In France, the *Ecole Nationale d'Administration* (ENA) occupies a similarly pre-eminent niche. Its importance, one observer of French diplomacy has written, reflects the radical transformation of the nature of the diplomat's job, and the fact that social influence is no longer a matter for the salons.¹¹⁹

Debate on these questions has moved along some well-trodden paths. Instrumentality rather than equity is the criterion. The qualities required of diplomats, including intelligence and tact, functional expertise, possession of a cast-iron digestion,¹²⁰ or the social skills that shield their possessor from intimidation by politicians,¹²¹ are not likely to be exclusive to members of certain tightly defined groups in society. The question of recruitment does, however, have some importance in wider organizational terms. If negative images are held of diplomats, good candidates may be deterred from applying.¹²² And business executives may be that much more unlikely to talk the same language as officials. Solutions have not usually been sought at the recruitment point, but rather at that of lateral mid-career recruitment or secondment. Several foreign service reviews have emphasized the need for more private sector people to be brought in, as in Sweden, on short-term bases. The expectations of recruits may not tally with the realities of the job, but these expectations may nevertheless shape foreign service administration practices to some extent. In Australia the

Department of Foreign Affairs has been criticized for espousing a closed-shop outlook on overseas activities, a practice “aggravated by the glamorous concept of diplomatic life which exists in the community.” Existing recruitment practices produced a similarity of type, though not necessarily of political views, and narrowed the knowledge and experience of Australian life which existed in the foreign service.

Although there are exceptions, most diplomatic cadets are persons in their 20s with only minor experience of work and adult life beyond the tertiary educational stage. From the moment of their selection they see themselves as potential heads of mission. Though they are brought back to Australia from time to time, these are short periods within their total diplomatic career service and their return does not bring them within the normal Australian environment, but finds them still within the Department of Foreign Affairs in Canberra, working with a similar diplomatic environment.¹²³

In a hypothetical worst case, then, conditions of work during a normal foreign service career may act to reinforce a kind of cosmopolitan insularity of outlook. An officer may become well versed in the ways of foreign countries, but ill-informed about, or uninterested in, the concerns of other departments in his own country’s government. The result can be an ineffective foreign service machine, or else a bottleneck of highly qualified candidates at certain senior promotion points. There may also be consequences for morale, fed in turn by the tedium of National Day parties, the farmyard-and-factory-floor character of many of the issues, or the apparently ceaseless flow of review processes and reorganization aerobics. Recruitment patterns and socialization processes, then, are inextricably mixed. Staffing arrangements, as one report observed, have a powerful effect on attitudes and ethos, and hence, indirectly, on the kind of staff who opt to join them. “There is much that is valuable in this esprit de corps. But it has its disadvantages too. Being so strong it is quickly absorbed by new recruits and so tends to discourage innovative thinking about how the job should be done.”¹²⁴

Balancing the accumulation of specialist knowledge with the cultivation of generalist skills can be difficult. In an ideal world, these would be mutually reinforcing. In practice there are institutional obstacles to some options. The traditional separations, of foreign from domestic civil services, of diplomatic from commercial or consular services, or of mission- from home-based foreign ministry staffs, have already been discussed. A further institutional obstacle is that between career paths in industry and in government. The need for government to take advantage, through lateral recruitment and secondment, of skills and knowledge in the business community has been a recurrent theme of foreign service reviews. In Sweden, for example, a businessman might see working for a few years in the diplomatic service as a normal part of his career, while a member of the foreign service would view a period in industry in similar terms.¹²⁵

The question of what kind of in-service training, apart from career experience, is most appropriate for foreign service officers assumes that some sort of satisfactory answer can be given to the generalist-specialist dilemma. Appeal to an underlying intellectual discipline has been common. One critic of the West German diplomatic service has argued that contacts with the outside world are essential if foreign service offices are to avoid developing an ivory tower mentality. Part of the solution, he suggested, is for the foreign ministry to pay greater attention to the international relations theory of the Anglo-American tradition, since diplomacy in its broadest sense is concerned with the analysis of the relations between sovereign states.¹²⁶ Both the utility and the philosophical consistency of these kinds of writings can, however, be overemphasized. More piecemeal approaches to training have usually found more favour. Harold Nicholson, who wrote on diplomatic method, also recommended (in 1934) the establishment in Britain of a Diplomatic Staff College.¹²⁷ Reports from several countries have pointed to a need for more sabbatical leaves for foreign service officers, the creation or expansion of specialist training courses, joint seminars with industry, and more extensive collaboration with universities and research institutes.

Summary and Conclusions

The scope of international relations underwent dramatic changes in the second half of the 19th century. Governments began to devise international conferences and new forms of institutions to deal with a variety of new issues: mail deliveries between countries; the regulation of traffic on major international rivers; the gauges of railways linking states; and different types of international forums for tackling the perennial questions of war and peace. Since 1950 the pace and ramifications of change have posed challenges to past practices in the conduct of foreign policy. Some of these changes were summarized in a 1981 colloquium held in connection with the work of the Royal Commission on Conditions of Foreign Service: the clutter of actors, the glut of data, the surge of knowledge, the intractability of problems, and the evanescence of power.¹²⁸

The present report has been concerned with the impact of change on foreign ministries. These have in the past run some risk of becoming part of what the 19th-century English writer Walter Bagehot called the “dignified elements of the constitution,” such as the governor general — useful as advisers on protocol or purveyors of emollients to the powerful, but without their hands on the levers. Let us phrase the broad question in these terms: Should the coordinating instincts of foreign ministries be satisfied or thwarted?

In many countries, foreign ministries have often been protected by a lack of public interest in foreign affairs, conventions of executive responsi-

bility for foreign policy, or traditions of a bipartisan elimination of some areas from political discourse. When they arise, though, the criticisms can be far-reaching. The case against giving foreign ministries the nod rests on five main arguments.

- Foreign ministries are increasingly irrelevant. Their functions have been eroded by the growing international activities of traditionally domestic departments which have clearer conceptions of policies that are in the national interest.
- Changes in communications and travel make outmoded the traditional forms of foreign ministry and overseas post organization.
- The methods of recruitment and socialization of foreign service officers, the elevation of generalist attributes and the downplaying of specialist skills, and the cultivation of a foreign service mystique are among the features of foreign service organization and ethos that need to be changed.
- There is too little contact between officials working in domestic departments and those in the foreign ministry or in overseas posts.
- Foreign ministries and their staffs at home and abroad do not pay sufficient attention to either domestic requirements and priorities or to matters of broad economic policy.

On the other hand, some form of external representation is clearly needed because any country's interests are increasingly affected by what goes on outside it. Foreign service officers are more likely than their counterparts in domestic departments to have a radar capability.¹²⁹ The case for building on this capability in the organization of the foreign policy community can be summarized as follows.

- Because of its specialist concerns and domestic constituencies, a home department cannot be aware of and protect broader diplomatic or political interests.
- A measure of coordination is needed in foreign affairs: the spread of discrete sectoral foreign policies pursued by functional departments can be damaging. This kind of coordinating work can best be performed by foreign ministries because their range of sight extends over all sectors.
- Foreign policy work as traditionally conceived continues to be an important function of government.
- Too much emphasis on the cultivation of narrowly based expertise will drain foreign ministries of their resources of leadership personnel.
- The fact that heads of government have increasingly become involved in international affairs underlines the requirement for one central agency of government with broad-ranging foreign policy responsibilities. Foreign ministries are the best equipped to act as central channels between political leaderships and domestic bureaucracies in the field of international affairs.

Canada has made a number of attempts, particularly since the late 1960s, to grapple with these kinds of questions. Some of the trends in Canada, such as greater administrative integration of staffs of various departments having some kind of foreign affairs responsibilities, have their parallels in other countries. The difficulties confronting coordinating exercises, such as the Interdepartmental Committee on External Relations (ICER), have also been echoed elsewhere, particularly when — as in the case of Australia — firmly entrenched domestic departments have been efficient guardians of their domains. Some of the newer areas of international economic policy, such as the law of the sea negotiations in the 1970s, have fallen primarily to external affairs departments both in Canada and in a number of other Western countries by dint of their cultivation of pertinent expertise.

Intriguing parallels can also be drawn in some of the underlying circumstances that condition the making of foreign policy. Like New Zealand, for example, Canada is part of an international region of two states, a fact which, like New Zealanders, many Canadians would often prefer to forget. Geographical, cultural and economic forces in Canada tug simultaneously in three different international directions, as they do in Switzerland.

These factors do not point unambiguously toward one conclusion as far as the organization of the Canadian foreign policy community is concerned. The role of the provinces, for example, distinguishes Canada from other Western federal systems. There are no roles for the Australian states or West German Länder comparable, for example, to those of provincial governments in the consultative mechanisms associated with the joint Canada-EC official machinery. External Affairs in Canada can thus be criticized for trampling geographically as well as functionally, a significant added dimension to the domestic chess game. On the other hand, this extended range of domestic actors, both governmental and non-governmental, magnifies the problems inherent in the foreign economic policy process, and can therefore be taken as further evidence of the need for one central coordinating agency. Similarly, the ease of communications and contact with the United States highlights the transformations that have characterized the conduct of diplomacy more generally, and the nature of the issues in Canadian-American relations — from dams and fish to pollution and cement — underlines the changing scope of international agendas. Canadian diplomacy has responded in various ways to the facts of life in Washington, where the diplomatic task is complicated by the unremitting pluralism of the policy community, the constitutional division of executive and legislative powers inherent in the American “checks and balances” system of government, and the preoccupation of U.S. policy makers with their superpower responsibilities. As the ICER experiment indicated in the early and middle 1970s, however, notions of coordination

in foreign policy cannot easily be grafted onto bilateral situations, like this, in which the distinction between foreign and domestic policy is in an advanced state of decay.

Foreign ministries tend to respond to the anticipated criticisms of reviews by arguing that substantial change has already taken place, that officers do specialize, that they are competent to handle a range of complex economic policy matters and are recruited from a broader base than was traditionally the case. Indeed the extent of change is often inadequately appreciated. As a Dutch foreign minister in the 1930s remarked, “A diplomat does not talk about cheese,”¹³⁰ a subject of some importance to Canadian foreign service officers negotiating with European officials in the 1970s.¹³¹ The kinds of fisheries questions found “ludicrous” by one observer of British EC membership negotiations in the early 1970s¹³² were, similarly, central issues in Ottawa’s relations with Brussels later in the decade.¹³³ The British ambassador to Iran in the 1973–79 period noted later that, though the task of relaying back to London information about the Shah’s position was important, it was not his main job: “First came export promotion in all its aspects. . . . The core of the Embassy became the commercial section. . . . Study of the internal political situation in Iran was an important, but subsidiary activity.”¹³⁴

The reorganization of the conduct of foreign affairs in Canada in January 1982 is an exception to the general rule for Western countries that such institutional readjustments take place gradually, and stop short of grand syntheses. Australia’s Royal Commission on Government Administration considered, but did not recommend, the creation of a new foreign policy mega-department; Britain’s CPRS review in 1977, proposing the setting up of a ministry of exports, toyed with, but drew back from, the idea of a future department for all overseas affairs. The strength of international trade bodies in the Federal Republic of Germany and in Japan precludes such integrative options. This broader comparative record seems to suggest that, though there are costs to a fragmented administrative picture, there are also compensating advantages. Trade ministries and foreign ministries by their nature occupy overlapping circles. Schemes to eliminate all or most of these overlaps can have a superficial attractiveness, but at the cost of a loss of the distinctiveness and competitive edge of the component parts. Duplication, overlap and conflict have become much-maligned words in debates on foreign policy institutions in Western countries; in the process the benefits to society of their partial rehabilitation have sometimes been overlooked. More particularly, the merit of having distinctive trade bodies in government at home — whatever the method of organization abroad in missions — probably increases to the degree that more active mechanisms of collaboration between government and the private sector are sought.

Foreign ministries have been surprisingly good survivors. They are constrained, after all, by certain facts of political life. Domestic departments

have constituencies; they serve clients whose support may be counted on in a crunch; publics have expectations of them which, whether fulfilled or not, spring from assumptions of their importance. Foreign ministry intervention in internationalized domestic issues, on the other hand, can spark criticism of their alleged readiness to sell out national interests for spurious diplomatic gains. The physical danger of working abroad in the 1980s can attract public sympathy; and the occasional exploit which secures public attention or which casts the diplomat in the lead on important domestic matters — fisheries in Britain, acid rain in Canada, agriculture in France — can produce praise. But in general the foreign service officer is like Dr. Johnson's lexicographer, who "can only hope to escape reproach, and even this negative recompense has been granted to very few." Foreign ministries tend to lack, then, a theory of government or public administration which could serve to legitimize a wider coordinating role in external relations. Whereas the role of the fisheries ministry in relation to fisheries policy is reasonably clear in principle, that of a foreign ministry in relation to foreign policy is not.

In the course of this report we have looked at a variety of ideas for change. Many are already in working practice. Some of the recurrent ones can be reviewed briefly.

- Foreign ministries need to develop more capabilities for dealing with economic matters.
- Some overseas posts may need reorganization in order to devote greater resources to economic tasks; the functional specialization of missions may be needed in some cases. Continuous monitoring of requirements should be instituted.
- Consultative and coordinating mechanisms of various kinds inside government are an integral part of the management of external relations. Greater interchange and contact should mark the career paths of officers in foreign and in domestic departments.
- Lateral recruitment from industry is one means of promoting active contact between foreign ministries and business communities.
- Greater attention should be given to the specialist training needs of foreign service officers. There is room for a variety of working contacts with universities, research institutes, industry, and non-governmental bodies in this regard.

It might be objected that some changes have already been taken too far. Economic tunnel vision is hazardous. One consequence in Britain in the mid-1980s of greater civil service attentiveness to the private sector was an increase in the number of senior officials departing government for greener pastures outside. And in the final analysis it is evident that there is a limit to what can be achieved in terms of policy performance by institutional change. Interdepartmental committees do not sell goods. The success of Japanese competitiveness in world markets is the result of

technological innovation and the quality of product, not of efforts by the staff of MITI or the foreign ministry in Tokyo. Yet foreign economic policy institutions, within these parameters, are important. Not merely passive filters for the flow of economic forces, they are located at the strategic points of contact of national and international economies.

Notes

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In discussing royal commissions or reports in this study, abbreviations or short titles have sometimes been used. Full titles of those most relevant are listed below.

CPRS: Central Policy Review Staff, a section of Review of Overseas Representation, United Kingdom, 1977. (Note 3)

Devlin report: Report of Public Service Organization Review Group, 1968–69, Ireland, 1969. (Note 87).

Duncan report: Report of the Review Committee on Overseas Representation 1968–69, United Kingdom, 1969. (Note 15)

Fulton report: Civil Service Affairs: Comments to the Committee under the chairmanship of Lord Fulton. Home Civil Service, United Kingdom, 1960.

Glassco report: Royal Commission on Government Organization, Ottawa, 1962–63. J. Grant Glassco, Chairman.

Herbecq report: Report of a Working Group on the Interchange between the Home Civil Service and the Diplomatic Service, United Kingdom, 1978. (Note 48)

McDougall Report: Royal Commission on Conditions of Foreign Service, Canada, 1981. (Note 2)

McGill report: The Role of the Department of External Affairs in the Government of Canada, Ottawa, 1976.

Murphy commission: Commission on the Organization of the Government for the Conduct of Foreign Policy, United States, 1975. (Note 9)

Plowden report: Report of the Committee on Representational Services Overseas 1962–63, United Kingdom, 1964. (Note 40)

RCAGA: Report of the Royal Commission on Australian Government Administration, Australia, 1976. (Note 8)

1. James Eayrs, "The Department of External Affairs," in *The Times Survey of Foreign Ministries of the World*, edited by Zera Steiner (London: Times Books, 1982), p. 96.
2. Royal Commission on Conditions of Foreign Service, *Report*, (Ottawa: Minister of Supply and Services Canada, 1981), p. 55.
3. For example the Central Policy Review Staff (CPRS) report in Britain, *Review of Overseas Representation* (London: HMSO, 1977), made use of six analogous countries: Australia, Canada, France, the Federal Republic of Germany, Italy and Japan. Attention to Canadian developments runs through various Australian reviews and reports.
4. Masakuma Uchiyama, "The Foreign Office of Japan: Past and Present," *Keio Journal of Politics* (1976), p. 3.

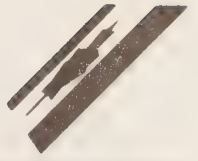
5. Hans J. Morgenthau, *Politics among Nations* (New York: 1961), p. 545ff. See also D. McLacklan, "The Death of Diplomacy," *Twentieth Century* 149 (1951): 173–80; Harold Nicholson, *The Old Diplomacy and the New* (David Davies Memorial Institute of International Studies, 1961); Q. Wright, "The Decline of Classic Diplomacy," *Journal of International Affairs* 17, (1963); Lord Vansittart, "The Decline of Diplomacy," *Foreign Affairs* 28 (1950): 177–88.
6. Max Beloff, *New Dimensions in Foreign Policy* (London: Allen and Unwin, 1961); R.F. Hopkins, "The International Role of 'Domestic' Bureaucracies," *International Organization* 30, (1976): 405–32.
7. Patrick Keatinge, *The Formulation of Irish Foreign Policy* (Dublin: Institute of Public Administration, 1973), p. 144.
8. Royal Commission on Australian Government Administration (RCAGA), *Report* (Canberra: AGPS, 1976), para. 10.4.9, p. 333.
9. Harlan Cleveland, "The Management of Multilateralism," in *Commission on the Organization of the Government for the Conduct of Foreign Policy, June 1975* (Washington, D.C.: GPO, 1975), Appendices, Vol. 1, p. 262.
10. CPRS, *Review of Overseas Representation*, para. 3.10, p. 15.
11. *Jahresbericht der Bundesregierung, 1979* (Bonn: Presse- und Informationsamt der Bundesregierung), p. 27.
12. CPRS, *Review of Overseas Representation*, para. 19.2, p. 305.
13. *Ibid.*
14. For example, Richard Gott, *The Guardian*, April 16, 1968.
15. *Report of the Review Committee on Overseas Representation 1968–69, Chairman: Sir Val Duncan*, Cmnd. 4107 (London: HMSO, 1969), chap. 1, para. 1, p. 9. This includes the operations of representatives abroad, and of departments directly concerned at home. Use of foreign exchange, though, is significant.
16. "Foreign Affairs would prosper if the 1960s could become known as the decade in which the American Foreign Service was *not* reorganized"; a U.S. official quoted in Sir Douglas Busk, *The Craft of Diplomacy: How to Run a Diplomatic Service* (New York: Praeger, 1967), p. xii.
17. CPRS, *Review of Overseas Representation*, para. 1.9, p. 3.
18. "Submission by Professor P.J. Boyce," in *Commonwealth of Australia Senate. Standing Committee on Foreign Affairs and Defence: Australian Representation Overseas — The Department of Foreign Affairs* (1978), vol. 2, p. 978.
19. Geoffrey Hawker, R.F.I. Smith and Patrick Weller, *Politics and Policy in Australia* (St. Lucia: University of Queensland Press, 1979), p. 16.
20. Heinrich End, *Erneuerung der Diplomatie: Der Auswärtige Dienst der Bundesrepublik Deutschland — Fossil oder Instrument?* (Neuwied: Hermann Luchterhand Verlag GmbH, 1969), p. 123.
21. Busk, *The Craft of Diplomacy*, pp. 1–2.
22. Gerhard von Glahn, *Law Among Nations*, 3d ed. (New York: Macmillan, 1976), p. 378.
23. CPRS, *Review of Overseas Representation*, para. 9, p. xi, and parts II, III, *passim*. "Foreign policy work" was that connected with international political situations and activities, and "political work" the conduct of day-to-day bilateral political relations and the political analysis of foreign countries.
24. "Submission by the Department of Foreign Affairs, . . ." para. 2.1.1, 2.1.8–10, in *Commonwealth of Australia, Senate. Standing Committee on Foreign Affairs and Defence: Australian Representation Overseas — The Department of Foreign Affairs* (1978), vol. 1, pp. 14–18.
25. Royal Commission on Conditions of Foreign Service, *Report*, p. 44.
26. Richard J. Van Loon, "Kaleidoscope in Grey: The Policy Process in Ottawa," in *Canadian Politics in the 1980s*, edited by Michael S. Whittington and Glen Williams (Toronto: Methuen, 1981), pp. 292–93.
27. Some moves followed at lower levels. See W.M. Dobell, "Indepartmental Management in External Affairs," *Canadian Public Administration* 21, (1978): 90.

28. See Gordon Osbaldeston, "Reorganizing Canada's Department of External Affairs," *International Journal* 37 (1982): 456; and J.R. Maybee, "ICER and its Two-Year Search for an Approach to Integration," *International Perspectives* (September/October 1972): 4-43.
29. Dobell, "Interdepartmental Management," p. 95.
30. See *ibid.*, pp. 84, 88-89.
31. Osbaldeston, "Reorganizing Canada's Department of External Affairs," p. 457.
32. Royal Commission on Conditions of Foreign Service, *Report*, p. vii.
33. *Ibid.*, pp. 51-52, 55. Additional integration steps were taken during 1981. For discussions see the contributions by Sir Geoffrey Jackson, Lord Garner, Rufus Z. Smith, Martin F. Herz, and J.L. Granatstein, in *International Journal* 37 (1982): 378-412. See also T.A. Keenleyside, "Lament for a Foreign Service: The Decline of Canadian Idealism," *Journal of Canadian Studies* 15 (1980-81): 75-84.
34. Office of the Prime Minister of Canada, "Reorganization for Economic Development," Press Release, January 12, 1982, pp. 1-2.
35. At the ministerial level, the Secretary of State for External Affairs was to be joined by two ministers, a Minister for International Trade and a Minister for External Relations (designated initially as Minister of State, International Trade, and Minister of State, External Relations, respectively). The matching senior officials were the deputy minister, International Trade, a position linked with that of coordinator, International Economic Relations, and the deputy minister, Foreign Policy (or Political Affairs). A management committee was designed to give overall departmental direction.
36. See Osbaldeston, "Reorganizing Canada's Department of External Affairs," pp. 461-62.
37. For an earlier criticism, see J. Meyer, "We're Relying Too Much on Exports," *Executive* (December 1977): 21-22.
38. These points are enlarged on in James Rusk, "Straightening out Merger Mess First Major Challenge for Masse," *Globe and Mail* November 3, 1982, p. 9.
39. Haruhiro Fukui, "Policy-making in the Japanese Foreign Ministry," in *The Foreign Policy of Modern Japan*, edited by Robert A. Scalapino (Berkeley: University of California Press, 1977), p. 25.
40. *Report of the Committee on Representational Services Overseas Appointed by the Prime Minister under the Chairmanship of Lord Plowden, 1962-63*, Cmnd. 2276 (London: HMSO, 1964), para. 2-4, pp. 1-2, para. 51-57, pp. 16-18.
41. RCAGA, *Report*, para. 9.4.43-47, pp. 365-66.
42. "Submission by the Department of Foreign Affairs . . .," para. 8.1-5, p. 177.
43. J.J.C.H. Voorhoeve, *Peace, Profits and Principles: A Study in Dutch Foreign Policy* (The Hague: Martinus Nijhoff, 1979), pp. 71-75.
44. End, *Erneuerung der Diplomatie*, p. 48.
45. Jørgen Grønnegård Christensen, "Blurring the International-Domestic Politics Distinctions: Danish Representation at EC Negotiations," *Scandinavian Political Studies* 4 (1981): 205.
46. *Plowden Report*, para. 61, pp. 18-19.
47. CPRS, *Review of Overseas Representation*, chap. 21.
48. Civil Service Department, *Interchange between the Home Civil Service and the Diplomatic Service. Report of a Working Group (Chairman Sir John Herbecq)*, mimeographed, 1978, para. 11, 37(i), 37(x).
49. J. Niezing, "Diplomatie: een organisatie in beweging. II. Enig statistisch materiaal m.b.t. de Nederlandse buitenlandse dienst," *Acta Politica* 4 (1969), p. 268, n. 22.
50. End, *Erneuerung der Diplomatie*, p. 105.
51. Humphrey Trevelyan, *Diplomatic Channels* (London: Macmillan, 1974), p. 20.
52. Steiner, ed., *The Times Survey*, p. 13.
53. *Ibid.*, p. 20.
54. Hawker, Smith and Weller, *Politics and Policy in Australia*, pp. 206-207.

55. Ibid., pp. 207–26.
56. Uchiyama, “The Foreign Office of Japan,” p. 9.
57. *Duncan Report*, chap. 4, para. 29, p. 56.
58. CPRS, *Review of Overseas Representation*, para. 5.26, p. 40.
59. Ibid., pp. 40–41.
60. Ibid., para. 5.28.
61. *Duncan Report*, chap. 4, para. 6.
62. RCAG, *Report*, para. 9.4.57, p. 269.
63. Ibid., para. 9.4.58, recommendations 233, 234.
64. CPRS, *Review of Overseas Representation*, para. 3.24, p. 19.
65. Ibid., para. 5.60, p. 51.
66. Ibid., para. 5.61, pp. 51–52.
67. Busk, *The Craft of Diplomacy*, p. 34.
68. Ian G. Sharp, “Report on Overseas Service,” in RCAGA, *Report*, Appendix, vol. 3, pp. 401–402.
69. Steiner, *The Times Survey*, p. 17. More generally, see “Coordination in Complex Settings,” in *Commission on the Organization of the Government for the Conduct of Foreign Policy*, vol. 7 (app. 5). (Washington, D.C.: GPO, 1975).
70. Cited by Hawker, Smith and Weller, *Politics and Policy in Australia*, p. 19.
71. RCAGA, *Report*, para. 9.4.50, p. 267. The figures exclude establishments maintained at Butterworth in Malaysia and in Antarctica. For U.K. figures see “U.K. Overseas Representation, 1975–76,” in CPRS, *Review of Overseas Representation*, Table 4.3, p. 27.
72. “Specialattachéer,” *Rapport fra Arbejdsgruppen Vedrørende Udenrigsministeriets Struktur* (København: Administration departmentet, 1979), Bilag 7. On the French and Italian practice of the foreign trade ministry sending the government’s foreign trade officials abroad see End, *Erneuerung der Diplomatie*, p. 47.
73. Voorhoeve, *Peace, Profits and Principles*, p. 75.
74. Martin Painter and Bernard Carey, *Politics between Departments: The Fragmentation of Executive Control in Australian Government* (St. Lucia: University of Queensland Press, 1979), p. 10.
75. Chalmers Johnson, “MITI and Japanese International Economic Policy,” in Scalapino, *The Foreign Policy of Modern Japan*, pp. 227–28, 231–33.
76. *Jahresbericht der Bundesregierung, 1979*, pp. 170ff., pp. 243–45.
77. Lord Strang, *The Foreign Office* (London: Allen and Unwin, 1955), pp. 21, 148.
78. On the pros and cons of distinct as against unified services, see *Duncan Report*, chap. 3, para. 1, p. 34. It was thought that a distinct diplomatic service was needed, but with the degree of separateness being minimized.
79. CPRS, *Review of Overseas Representation*, para. 7.20, p. 115, and para. 6.108, 6.109, pp. 89, 91.
80. Hawker, Smith and Weller, *Politics and Policy in Australia*, p. 209.
81. Ibid., p. 219.
82. Economic Policy Task Force, 1975, cited in *ibid.*
83. Watt, cited in *ibid.*, pp. 225–26.
84. Ibid.
85. RCAGA, *Report*, para. 10.4.17, p. 335.
86. “Arbejdsgruppens forslag til struktur for udenrigsministeriet,” *Rapport fra Arbejdsgruppen Vedrørende Udenrigsministeriets Struktur*, Bilag 11.
87. *Report of Public Service Organization Review Group, 1966–69* (Dublin: Stationery Office, 1969), para. 24.31–42, pp. 259–60; Keatinge, *Irish Foreign Policy*, pp. 117–18.
88. *Jahresbericht der Bundesregierung, 1979*, p. 26.

89. Uchiyama, "The Foreign Office of Japan," pp. 9–10.
90. Hans-Peter Schwarz, ed., *Handbuch der Deutschen Aussenpolitik* (Munich, 1975), pp. 68, 72.
91. Jørgen Grønnegård Christensen, "The Presidency as Routine: The Case of Denmark." Mimeographed.
92. End, *Erneuerung der Diplomatie*, p. 123.
93. Hawker, Smith and Weller, *Politics and Policy in Australia*, p. 13.
94. Schwarz, *Handbuch der Deutschen Aussenpolitik*, p. 72.
95. RCAGA, *Report*, Appendix, vol. 3, p. 291.
96. CPRS, *Review of Overseas Representation*, chap. 6; and "A Department of Overseas Affairs," Annex Q, pp. 436–38.
97. Busk, *The Craft of Diplomacy*, p. 78.
98. Peter R. Baehr, "The Foreign Policy of the Netherlands," in *The Foreign Policy of the Netherlands*, edited by J.H. Leurdijk (Alphen aan den Rijn: Sijthoff & Noordhoff, 1978, p. 5.)
99. "Submission by Professor P.J. Boyce," p. 979.
100. *Duncan Report*, chap. 6, para. 30, p. 80.
101. CPRS, *Review of Overseas Representation*, para. 6.112, p. 92.
102. *Ibid.*, para. 15, p. xiv, and para. 6.96, pp. 84, 86.
103. *Ibid.*, para. 6.15, p. 64.
104. J. Niezing, "Diplomatie: een organisatie in beweging. I. Een evaluatie van literatuur," *Acta Politica* 4 (1969): 154–59.
105. The FCO objections to CPRS suggestions for greater specialization were that technique expertise and region expertise were more important than subject expertise; the degree of subject expertise required was exaggerated; specialization would distort officers' judgment, would prevent them from discovering through experience which functions they were best at, would prevent "fliers" from acquiring the breadth of experience needed at the top, would cut officers off from links with other departments, was bad for job satisfaction, would lead to cliquishness in overseas posts, and would lead to some staff spending the whole of their careers in pleasant posts, with a second-class service confined to dangerous and uncomfortable countries (CPRS, *Review of Overseas Representation*, para. 21.13, pp. 339–41). On the issues in Canada see, for example, T.A. Keenleyside, "The Generalist versus the Specialist: The Department of External Affairs," *Canadian Public Administration* 22 (1979): 51–71.
106. *Duncan Report*, chap. 5, para. 16, p. 63.
107. RCAGA, *Report*, para. 10.1.38, p. 309.
108. *Ibid.*, Appendix, vol. 3, pp. 394–95, 400.
109. Busk, *The Craft of Diplomacy*, p. 72.
110. *Ibid.*
111. Baehr, "The Foreign Policy of the Netherlands," p. 11.
112. *Ibid.*, p. 12.
113. CPRS, *Review of Overseas Representation*, para. 6.4, 6.5, pp. 59–60; and Table 6.2, p. 61.
114. *Ibid.*, Table 5.1, p. 31.
115. *Ibid.*, para. 5.3–15, pp. 32–37.
116. Fukui, "Policy-making in the Japanese Foreign Ministry," p. 23.
117. Voorhoeve, *Peace, Profits and Principles*, p. 71.
118. Fukui, "Policy-making in the Japanese Foreign Ministry," p. 20.
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120. Busk, *The Craft of Diplomacy*, p. 196.
121. Hayter, cited in *ibid.*, p. 200.

122. Ibid., p. 184.
123. RCAGA, *Report*, Appendix, vol. 3, 397.
124. CPRS, *Review of Overseas Representation*, para. 21.22, p. 344. See also Baehr, "The Foreign Policy of the Netherlands," pp. 11-12.
125. *Duncan Report*, chap. 6, para. 35, p. 81.
126. End, *Erneuerung der Diplomatie*, pp. 118-119.
127. Busk, *The Craft of Diplomacy*, p. 222.
128. Royal Commission on Conditions of Foreign Service, *Report*, pp. 387-88.
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132. Uwe Kitzinger, *Diplomacy and Persuasion: How Britain Joined the Common Market* (London: Thames and Hudson, 1973), p. 97.
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The Emerging Cost Structure of Canadian Firms:

Some Implications for International Economic Policy

F.J. CHAMBERS

Introduction

The international economic policy followed by any country is always the product of a multitude of forces and constraints. For Canada, the process of reaching an international economic policy that is acceptable to all the major interest groups in the country is especially complex. Much of this complexity originates in the open nature of the Canadian economy. A large part of Canadian production and employment is subject to foreign competition, either through exports or from imports. It follows that changes in foreign market conditions, especially in the United States, have an immediate and even magnified impact on the Canadian economy. Because of the major role that foreign investment flows have in Canadian economic development, changes in international financial conditions also are a dominant factor in Canadian international economic policy.

The complexity of the subject is further heightened by the heterogeneous nature of the Canadian domestic economy. Distinct and highly differentiated regional economies produce quite diverse interests in and reactions to Canadian policy toward the foreign economic environment. The factor endowments, the patterns of investment and employment, and the interest in access to foreign markets and foreign capital vary from region to region. The need to compromise very different regional interests in Canadian foreign economic policy has been a major consideration for Canadian policy makers in the past, and will continue to be a primary constraint in the future.

The pattern or structure of industrial output in Canada is also complex and diverse, partly reflecting the regional nature of the country. From an international perspective, Canada is a major producer of a wide range of resource products, including foodstuffs, forest products, minerals and

energy commodities. But from a domestic perspective, Canada has a well-developed and mature secondary manufacturing base that must compete against the growing manufacturing capacity of the world. Each of these major goods-producing sectors of the Canadian economy has its own particular interests in Canadian foreign economic policy, which do not always coincide. Their differing interests in foreign economic policy have been analyzed and debated for many years, and many of the points of view and pressures on policy makers may be expected to continue. However, this paper suggests that some major changes may be taking place within the internal cost conditions of firms, especially in secondary manufacturing, which may lead to important changes in the way Canadian secondary industry views an appropriate Canadian foreign economic policy.

In a short paper, it is important to limit the range of issues raised and to focus on one or two dominant factors that may produce significant pressures causing an adjustment of policy. In the first place, foreign economic policy covers a wide range of issues including international financial institutions, international development assistance, immigration, defence purchases, technology transfers, and even immigration. The satisfactory coverage of these issues would be well beyond the scope of a short paper. This analysis, therefore, relates to only two aspects of foreign economic policy, although they are very major ones. The first aspect might be labelled "market access policies"; this would cover tariff policy (both Canadian and foreign) as well as nontariff barriers to the free flow of goods. The second aspect will be investment flows that are directly related to the creation of the capacity to produce goods and services. Investment flows for government and public utility financing will not be addressed.

The paper will not attempt to catalogue and review all of the domestic constraints on foreign economic policy. The range of economic, political and social factors that constrain and mould Canadian foreign economic policy is so large that a short survey could only provide a superficial listing. Furthermore, many of these constraints are being addressed by other papers under preparation for this Royal Commission. In particular, the regional constraints related to trade policy are being covered very thoroughly.¹

Instead, the focus is on an emerging pattern in the cost structure of firms. It identifies first the sources of change to the cost structure, and then the implications of these changes on the marketing and investment strategies of the firms. It is then a fairly simple step to relate strategies at the level of the firm to their implications for an appropriate set of market access and investment policies at the national level.

Having identified the underlying thrust of the economic interests, the paper will attempt to trace how these pressures might become manifest. It will hypothesize about the way in which the basic change in interest at the level of the firm may be translated into changes in the positions and attitudes of other major interest groups affected by the new thrust of the

economic pressures. These groups include the labour movement, and provincial governments most directly involved, and finally, the federal government. The last section of the paper will therefore examine how the process of policy formulation on international economic issues might be affected by the underlying change in cost conditions.

The Evolution of the Cost Structure of Firms

The changes in cost structure outlined in this section of the paper may affect all firms and industries to some degree or other. But the primary focus will be on the evolution occurring in secondary manufacturing industries, which is most relevant. Because manufacturing is heavily concentrated in central Canada, it influences mainly business and labour organizations in that region, and the governments of Ontario and Quebec. Thus, while the following analysis pertains to certain types of firms operating anywhere in Canada, the macro impact is very regionally oriented.

The changes in the cost conditions confronting Canadian firms have evolved very rapidly in the past decade and a half. They have also originated in a number of sources; some are reflections of the international environment, while others reflect changes in the internal cost structure and strategies of the firms themselves.

The International Environment

The changes in the international environment have been well documented, or are now being examined in other studies in the Royal Commission's research program.² The major new factors will be set out here simply as premises for the argument to follow.

The first change to note is the growth of industrial capacity in the world over the past two decades. This expansion was partly produced by the postwar recovery of the European, Japanese and East Bloc economies. It can also be attributed to the growing industrialization of developing countries, as well as the simple accumulation of capacity throughout the globe in the past three decades. In most product lines, world capacity has caught up to world demand. To expand sales, then, the individual firm does not necessarily rely on an expanding world market; instead, it must emphasize productivity and reduce costs so that it can either maintain its market share or take it away from competitors.

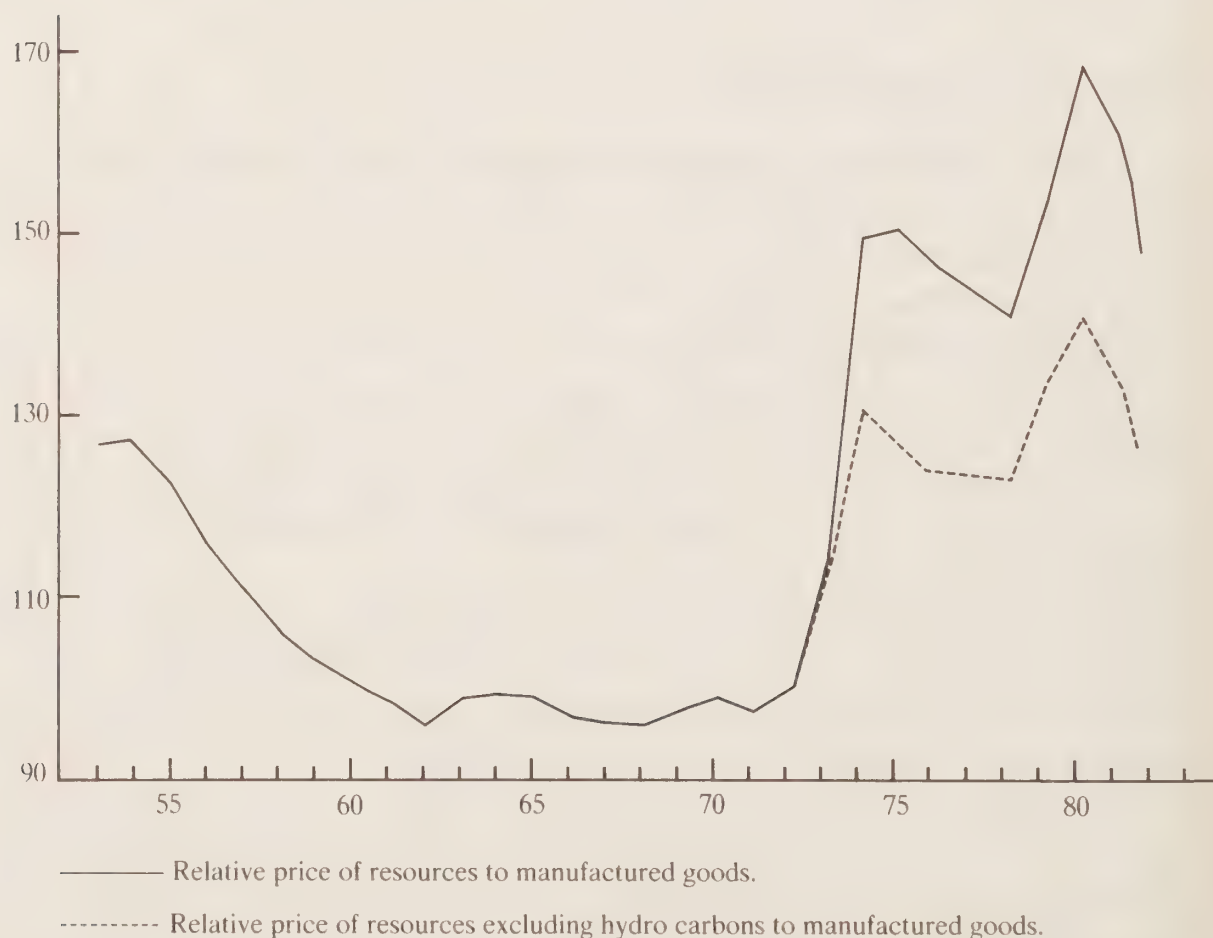
The expansion of world capacity in manufacturing has meant that the dominant comparative advantage of North America and Western Europe has been weakened. For those firms and industries that remain dedicated to traditional labour-intensive, standard production techniques, the comparative advantage has moved, or will move, to countries paying low wages. For those firms adopting more productive or newer automated production techniques, the comparative advantage, even for traditional products,

may stay in the older manufacturing regions. It is therefore not clear what is happening to comparative advantage of traditional manufacturing, other than to say that it can now be “engineered” to a far greater extent than in the past.

A second important change to the international environment has been the reduction in effective levels of tariff protection. Their decline has been partly caused by the reductions in nominal tariff levels in the Tokyo and Kennedy Rounds. The cumulative effect of these two rounds of tariff reductions will bring nominal tariffs on many product lines in Canada down to a range of nine to twelve percent. This level is less than the standard operating profit for most manufacturing industries, and thus offers little protection from an aggressive foreign producer.

An associated factor in the decline of the effective levels of protection has been the reduction in the marginal costs of many international producers (this argument will be developed later). This means that even the pre-Kennedy round of tariff levels would have ceased to be adequate to protect many product lines.³ The textile and clothing industries, for example,

FIGURE 4-1 Relative Price of Resource Products to Manufactured Goods Traded by Canada (base, 1966–73 = 100)



Source: *Bank of Canada Review* as presented in “The Economic Environment in the 1980s” (unpublished paper), Ministry of State for Economic Development, October 1982.

have increasingly used quantitative quotas, even though they still have high nominal rates of tariff protection.

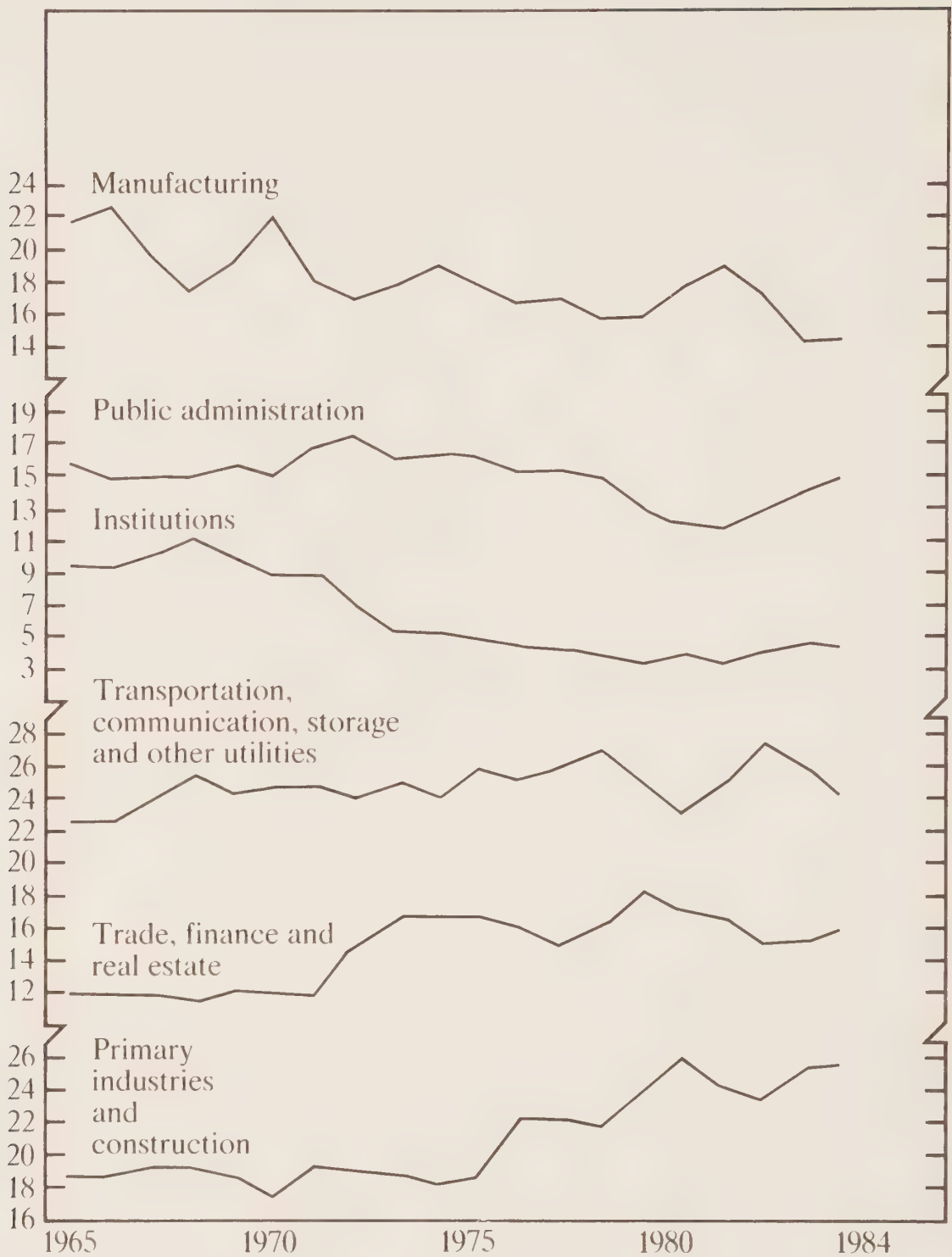
Yet another change in the international environment was a major shift in the price relationship of resources and resource-based products to manufactured products. Real prices of energy, food and forest products rose very sharply during the period, reversing a trend that had prevailed since the end of World War II (see Figure 4-1). Although hard rock minerals did not increase in price, the impact on other resource industries was very large. The high prices affected profits and led to major expansions in most resource industries.

The rapid growth of the resource industries, and the prospect that this growth would continue for some years, placed considerable pressure on the manufacturing regions of Canada. The nature of the pressure was not new; every resource boom in Canadian economic history has had a similar impact. However, the very rapidity and the apparent permanence of this growth were unusual. By the end of the 1970s, the rapid growth of resource industries was placing pressure on the manufacturing sector in two main ways. The first was the increased competition for capital and skilled labour. In 1978, 1979, 1980 and 1981 the migration of skilled tradespeople from central Canada to the West was becoming quite large.⁴ The impact of this migration was sufficient to reduce the potential rate of Ontario's growth by about one percent each year.⁵ In the absence of inflows of suitable immigrant labour, the rapid growth of the resource industries in eastern and western Canada implied a trade-off with the growth in the manufacturing industries of central Canada for the first time. The supply of skilled labour in Canada was not adequate to support the rapid expansion of both the resource industries and the manufacturing sector.

The potential high value of the Canadian dollar put a second pressure on the manufacturing industry. By the end of the 1970s the main economic growth patterns that emerged were resource based and export oriented. They were also capital intensive. Large capital requirements, which implied an inflow of capital, together with high export earnings, thus suggested a very high value for the Canadian dollar. This possibility affected the outlook for secondary manufacturing in Canada, since the sector is so sensitive to the level of the exchange rate. The rate affects not only the manufacturers' ability to export, but also their ability to compete in the domestic market. Thus, a fluctuating exchange rate, coupled with the impact of tariff reduction under the Tokyo Round of trade negotiations, pointed to a very difficult period ahead.

The environment created by all these international changes implied a very slow growth of sales and very poor investment prospects for Canadian manufacturing. These pressures led to a decline in the manufacturing share of capital expenditure in Canada (see Figure 4-2), and in the Ontario share of total Canadian private capital expenditures (see Figure 4-3).

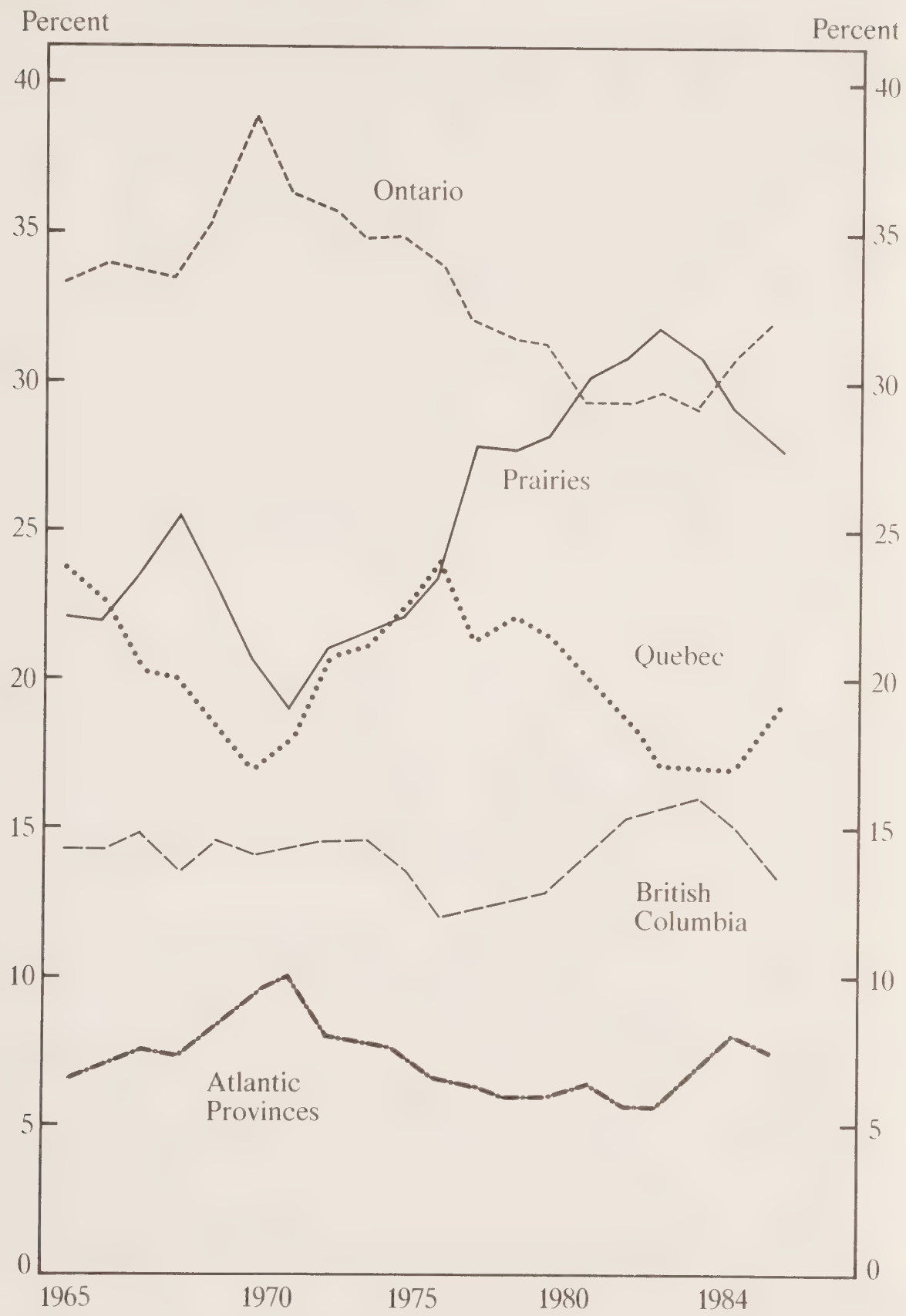
FIGURE 4-2 Capital Expenditure by Sector



Source: Statistics Canada, *Private and Public Investment in Canada*, Annual, Cat. 61-205.

Note: Excludes expenditures on housing.

FIGURE 4-3 Private Capital Expenditure by Region



Source: Statistics Canada, *Private and Public Investment in Canada*, Annual, Cat. 61-205.

Note: Excludes expenditures on housing, public administration and institutions.

Technological Change

The rate of technological change also intensified during the 1970s. Usually technological change has two important influences on business firms. First, it frequently leads to changes in product lines. Improvements in products, or the introduction of new products to serve either new or old demands tend to occur much more rapidly now than a few years ago. This means that the product life cycle tends to be shorter. Firms must then recover their costs and achieve a satisfactory rate of return on capital over a shorter period of time. This, in turn, means obtaining a large share of a large market as quickly as possible. In other words, a rapid rate of product obsolescence makes it difficult for a firm to survive on a small market base.

Perhaps an even more important influence is that of new process technology, since it can affect the cost of all products, both old and new. Process technology covers the whole range of automation and information-processing techniques. Its primary impact is to raise the productivity and lower the production costs of both traditional and new product lines.⁶ It therefore has the most potential to affect the level of productivity and employment in the Canadian economy.

The rate of diffusion of technology is a key factor in improving productivity. Both modern communications and the extended operations of multinational firms have sharply decreased the lag time between the invention of new techniques and their applications. One of the main competitive differentials between firms now is their capacity to obtain and apply new technology to improve productive efficiency. This imperative places a great onus on the management of a firm; it also places an onus on governments to provide a policy framework that enables and encourages firms to seek out and adopt new technology.

New process technology is always incorporated into the production process through investment. The investment may be either in machinery and equipment or in specially trained labour, or in both. Whichever the case, a substantial commitment of the firm's resources is required. More important, this process very often involves replacing labour with new equipment or automating jobs. This produces widespread unemployment and profound social problems, which are not the primary focus of this essay. Of more direct relevance is the fact that the substitution of capital for labour is, in effect, a substitution of fixed costs for variable or operating costs in the cost structure of the firm. This change in cost structure has an important impact on the firm's marketing strategy.

Marketing and Distribution Conditions

The marketing and distribution functions of firms have been subjected to two major influences in the past decade. The first influence is the improvement in transportation systems that permits the lower cost movement

of goods over long distances. The growth of an extensive network of good high-speed highways and the availability of long-distance trucking have thus made it technically and economically feasible to service a wide contiguous market from one location. Similarly, the availability of air freight service to many population centres has extended the concept of a contiguous market even further. Firms can now serve a very large geographical market from one or very few locations. This provides them with some scope to reduce their ratio of inventory to sales. Since such an ability is very desirable, many firms will wish to have dependable access to contiguous markets in order to exploit these new transportation and inventory capacities.

The second influence has come from the rise in interest rates. Since inventories are one of the main components of working capital, they are a major cost item. The interest cost of money is included in their overall costs: thus, the rise in interest rates has significantly increased the cost of carrying inventories. This factor has placed further pressure on firms both to reduce their inventory-to-sales ratio, and to make use of the transportation technology to service as large a contiguous market as possible.

Strategies for Manufacturing Firms

All these factors — the competitive international pressures, the rapid growth of the resource sectors, the changes in product and process technologies, the improved transportation systems, and the high interest rates — have placed great stress on the manufacturing industries of central Canada. What strategies can they adopt to counter or adapt to this pressure?

In principle, manufacturers have two main responses to the conditions they face. One response is to retreat before the competitive pressures and, for example, to seek new forms of protection such as subsidies, quotas, investment grants, special tax concessions, or even government participation in their enterprises. Their other response is to head firmly into the international competition and take it on. Such a response will also require appropriate government policies regarding investment and foreign commerce.

The first strategy involves little that is new either in terms of government policy or the firm's internal management techniques. But because the competitive pressures are very severe, and because tariff reductions have removed much of the traditional form of protection, there has developed a strong tendency, on the part of firms, to favour the new types of protectionism noted above. This response also temporarily alleviates their need to make internal adjustments to their operations so as to become more competitive. The relief, however, is temporary, since the competitive pressures soon combine to place them in a position requiring further assistance. The

strategy therefore implies a growing degree of support from governments — a support that is permanent.

The second response open to firms is more interesting, necessitating a more complex response on the part of governments. Essentially it entails making Canadian firms internationally competitive. To achieve this position in the face of the above-mentioned factors requires a major change in the product and marketing strategies of the firms, which will in turn require an appropriate set of international economic policies on the part of the government.

The capacity of firms to become internationally competitive hinges on their ability to manage the new cost structures they are facing. In general, all of the outlined changes have worked to increase the importance of fixed costs and reduce the proportion of variable costs for the firms. The main impact, however, on the cost structures comes from incorporating the new process technology and high productivity techniques into their productive system. Assimilating these elements requires a very high level of capital investment and often reduces the amount of manufacturing labour, therefore raising the ratio of fixed costs to variable costs.

An associated change also affects the remaining labour costs. As the capital intensity of the productive system increases, much of the remaining labour costs are related to management, engineering, sales, distribution, marketing and similar overhead costs. In an era of rapid product change and a shorter product life cycle, it is essential that firms maintain these functions to ensure their long-term survival. Even the production workers must be maintained if a large capital investment is to be kept operating. Thus, the related labour costs increasingly take on the character of fixed costs, with the result that both capital and labour costs become rigid and insensitive to the volume of output.

In recent years, this problem has been aggravated by the increase in interest rates. Higher interest rates simply compound the increase in fixed costs. The carrying costs of both fixed and working capital have risen sharply, although the problem can be minimized by reducing the size of inventories in relation to sales, as noted in the earlier discussion of inventories.

The insensitivity of capital and labour costs to the level of sales and output means that most of the fluctuation in sales and output must be absorbed by the profit rate, which consequently becomes much more unstable. Given the types of international competitive conditions outlined above, the average long-term profit rate in most lines of manufacturing cannot be inordinately high. The break-even capacity of a firm will thus be high — perhaps 75 to 80 percent, and the profits will all be earned in the capacity range of 80 to 90 percent. This places an excessive stress on the firm to maintain a high level of sales and output.

The problem comes into even sharper contrast when viewed from the perspective of an individual product line. Many firms maintain their

competitive positions by differentiating their products as much as possible through design or performance characteristics. Since these product characteristics tend to have a fairly short life expectancy, the firm must regularly introduce new product designs and features to the market. Each new product therefore will have to have its own production, marketing and servicing facilities.

At the same time, a high, fixed cost structure means that for each product line a firm may develop, the average total cost per unit of output may decline over an extended range of output. The marginal costs can also decline over a long period, becoming very small. Under these conditions, the firm may face increasing returns to scale virtually up to the point of full capacity, a possibility that raises all of the interesting and uncertain implications set out by Melvin. Under such circumstances, there could be a strong imperative to reach full output as quickly as possible, and to use marginal cost pricing if necessary.

The pressure to reach full output quickly is further augmented by a factor known in business policy literature as the “experience curve.” This concept was originally developed by the Boston Consulting Group, but a good exposition of the theory, including its limitations, has been set out in a note by the Harvard Business School.⁷ Although the concept of the experience curve is related to the traditional theory of increasing returns to scale, it departs from it in significant ways. The returns to scale theory, known also as the decreasing cost theory, is essentially a static concept. Take, for example, the firm that faces a given set of input costs to produce a product. If those costs have a high, fixed cost element, the firm can obtain lower unit costs as output increases simply by distributing the fixed costs over a larger number of units of output. This is the scenario described in the previous paragraph. Compared to the returns to scale theory, the experience curve is a dynamic concept: it holds that many of the unit costs of production, though not necessarily all of them, actually decline as output increases. Moreover, the unit costs are reduced as a function of accumulated output, not as a function of time. For example, each doubling of accumulated output might lead to a decline of 15 percent of the unit costs.

It is clear that a firm that is early into a market for a new product, and is able to increase its output quickly, can obtain a major cost advantage over its competitors. The speed with which it can keep doubling its output depends upon how far ahead of the competition it is, the size of the market and how easy it is to serve. A small market limits the speed with which output can be increased, and places a severe limit on the ultimate size of output that can be achieved. If the firm is competing against foreign firms that have access to a much larger market and are able to accumulate output much faster, it may find that the small market represents an impossible hurdle to international competitiveness.

Although there are limitations to the application of the experience curve, it does appear to apply to a wide range of products and firms in the manu-

facturing sector. The experience curve is particularly relevant to industries where either new products or significant varieties of old products are frequently introduced — in other words, where product differentiation is important. These products should also be directed at a fairly large market.

At one extreme, resource products are usually not subject to the experience curve since they are in long-term continuous supply (they are, of course, subject to other kinds of cost-cutting techniques). At the other extreme, products with only a very limited production, such as information systems or fashionable clothes, are not subject to significant effects of the experience curve. The concept, however, is relevant to many manufactured products: most household durables, consumer electronics, most mass-produced soft goods and utensils, computer hardware, and a wide range of manufactured capital goods. The concept is thus particularly relevant to the manufacturing sector.

In those product or market situations where the experience curve seems applicable, the advantages of a firm “going down the curve” as quickly as possible are made even more attractive by an empirically observed relationship between market share and the rate of return on capital.⁸ The empirical data suggest that there are great advantages to achieving at least a 30 percent to 40 percent share of the market for any product line. On the other hand, a share of less than 20 percent usually means that the firm will not earn an adequate rate of return on capital. Given this relationship, it may pay a firm to price low enough in order to quickly increase sales and output, thereby rapidly achieving a strong market position.

Many Canadian manufacturing firms are thus being faced with a more dominant fixed cost structure, with the added impact of the experience curve. Cost advantages are related to the rate of the firm’s growth as well as the ultimate size of output, which can be achieved more easily in a large market than in a small one. In addition, this market should be contiguous and efficient enough to serve and maintain a distribution system. Furthermore, since international competitors are also following the same imperatives, and they have a large domestic market to begin with, they can very quickly gain cost advantages and then use them to overcome traditional trade barriers. The only border defence available to Canadian firms against foreign competition of this kind lies in seeking the establishment of quotas or the direct prohibition of imports. Their only viable long-term defence, however, is to enter the game and try to establish a number of product lines in the larger market.

It is important to note that in order to win in this dynamic cost situation, a firm must take the major risk of committing a large investment in product development and manufacturing. It must also be prepared to take this risk repeatedly, since each product will have a relatively short life cycle. Such a risk can be taken, and the investments made, only if the firm has dependable access to a large enough market that will enable it to quickly expand

output and achieve a strong market position. Without this possibility, the risk cannot be taken and the expansion will not take place.

The question of dependable access to a market is not primarily a question of removing low tariffs. As already shown in the current cost dynamics, a tariff of 4 to 5 percent or even of 10 percent, is not a significant hurdle. What is of primary concern is contingency protection; that is, the ability to impose a whole range of quantitative controls or prohibitions that completely exclude a producer from an entire market, or part of a market. The Buy American rules and the recent concern over U.S. controls on imports of steel products are cases in point. Potentially these prohibitions pose a much greater constraint on future investments aimed at gaining a market share position than the calculable impact of a modest existing tariff.

In summary, those manufacturing firms opting for an international competitive strategy will require the ability to specialize by product line, together with the ability to expand sales as quickly as possible once new products have been introduced. They will want to have dependable, long-term access to a large, contiguous market where they can minimize their inventory and distribution costs. The only major market having the potential to meet these requirements is the United States.

One further question concerning the strategy of the business community remains to be addressed. This concerns the issue of whether foreign-owned multinationals are likely to react in a different way than Canadian-owned firms. The same international environment faces both types of firms, as do the same evolution of technology and costs. Conceptually, both foreign-owned and Canadian-owned firms could respond either with a protectionist or an internationally competitive stance. In fact, there are grounds to presume that the foreign-owned firms may primarily adopt a competitive stance, and thus no longer play a major role in advocating a continued protectionist stance in Canada.

The cost pressures and the reduction in tariff levels have made it impossible for either foreign- or Canadian-owned firms to produce a large number of products in each plant, passing the high operating cost on to the consumer. Specialization in one or a few product lines in each plant is necessary if the cost advantages outlined above are to be achieved. In this situation, foreign-owned multinationals have two basic options. They can close down their Canadian operations completely and serve the Canadian market from their home base, which is entirely possible if they are U.S. firms. Or, if they wish to maintain a base of operations in Canada for any reason, they must establish this base on an internationally competitive cost basis.

The latter option can be achieved by the specialization of Canadian production in one or very few product lines. This strategy, sometimes called "world product mandating," involves giving the Canadian plants or divisions the right to design, produce, market, and distribute a given product line

to most or all of international markets of a multinational enterprise (MNE).⁹ This marketing scope is essential because the Canadian market is seldom large enough to absorb the output of a highly specialized plant. Firms adopting this strategy include Westinghouse, IBM, Black and Decker, and to a considerable extent the North American auto companies under the Auto Pact. (The Auto Pact does not entail true product mandating since design, engineering, marketing and distribution are still centralized; however, production is specialized.)

This strategy thus requires very low barriers to trade. If a multinational's Canadian plants are exporting a few product lines to the rest of the world, then its foreign plants supply other product lines to the Canadian market. Free trade and a long-term commitment to free market access in both directions is a very important condition for this type of organization to work. Since the same condition is true if MNEs withdraw entirely from Canada, one can expect foreign-owned MNEs to be a major source of support for international economic policies favouring free trade.

Canadian-owned multinationals, of which there are a number in the manufacturing sector, will also be driven by much the same competitive forces. Although few of them would opt to withdraw completely from the Canadian market, they will still require specialization and a wide market area to maintain their competitive position. They are likely to place a fair amount of their production capacity outside of Canada to achieve their objective; Northern Telecom is a prime example of a multinational that adopted such a pattern.¹⁰

It has already been noted that such an organization of production and employment by multi-plant companies implies conditions of near free trade, as well as long-term, dependable access to the major markets. But it also implies that the dependence of the Canadian economy on trade will increase. Although the balance of trade and the balance of payments may net out as multinationals export as much as they import, virtually all of the goods involved will enter international trade flows. This situation has already been experienced under the Auto Pact, where the trade in automobiles dominates the Canadian statistics despite the near balance in the flows. It means that the Canadian economy would be even more sensitive to fluctuations in demand outside of Canada.

This organization of production also implies that the investment climate and the rate of return on capital in Canada must be competitive. Under the market conditions outlined above, the ability to move production and employment throughout the market area becomes a substitute, over time, for the movement of goods. If Canada is to attract and maintain a reasonable share of the production and employment in the total market area, then the availability of capital at competitive interest rates will be important. Tax rates that permit competitive after-tax rates of return will also be required.

The international competitive strategy is likewise a capital-intensive one. A large investment will be constantly needed to both incorporate new technology and cost-reducing equipment into the production system, and to re-equip new product lines. Some of the investment will have to come from external sources of funds. This is especially true of direct investment, which often brings technology and access to markets with it.

At the same time, however, the domestic financing of as much investment as possible will be important for a number of reasons. First, it would tend to maintain the level of Canadian ownership and control of enterprises. But more importantly, the less the foreign capital required to finance the economic structure, the less the capital inflows and, in turn, the less the pressure to raise the value of the Canadian dollar. In the internationally competitive scenario, the exchange rate for the Canadian dollar plays a crucial role: it mainly determines the final competitive relationship between Canadian industry and foreign competitors. Accordingly, any investment condition in Canada that reduces the net requirement for foreign capital becomes important. It is in this context, then, that the reduction of government deficits in Canada plays a key role in our foreign economic policies. The more the investment requirements are met in Canada, the more competitive Canadian industry is likely to be.

Impact on the Political Process

How will these evolving pressures at the level of the business firm affect the political process? The answer to this question is necessarily somewhat speculative but some broad patterns may be deduced from the nature of the changes. This section of the paper will trace the potential impact through three main groups participating in the policy process: the business community itself, the labour movement, and the provincial governments. These are the major, although not the only groups in Canada, that will articulate the constraints on the federal government as it formulates Canada's international economic policy.

The Business Community

The discussion of the nature of the changes in the business community has already provided the outlines of the positions likely to be espoused. The first important characteristic is that the new cost environment is primarily focussed on the manufacturing industry. The resource and resource-based industries are subject to great price competition, but their basic cost structures have not altered. They continue to be capital intensive and export oriented, and to have products with long or indefinite life cycles. They have always been interested in promoting an open trading system and achieving good access to foreign markets. There is no reason to believe,

then, that their interests and pressures will change over the coming decade.

Traditionally, the manufacturing sector in Canada has been protectionist since it was established behind the protection of the National Policy. Primarily concerned with serving the Canadian market, except in relatively few cases, it was not export oriented. This characteristic was especially true of many subsidiaries of foreign companies. They tended to produce a limited volume of each product drawn from a wide range of the parent companies' products, enabling them to serve the Canadian market but at the cost of the inefficient operation of each product line. As a result, the Canadian subsidiary did not develop the expertise necessary for foreign marketing. The contacts, as well as the knowledge of foreign markets and distribution techniques, all tended to be underdeveloped.

To a considerable extent, the same characteristics held true for many Canadian-owned firms. If their sole focus was on the Canadian market, their capacity for export business was limited. Adopting an export strategy therefore means not only adjusting production lines to become more efficient and competitive; it also means developing an extensive set of management capabilities. These are not always easy or inexpensive to develop.

Some of the larger Canadian manufacturers nevertheless did make this change during the 1960s and 1970s. They either tended to be in areas of rapid technological change, such as telecommunications, or they were the manufacturing subsidiaries of large, export-oriented Canadian resource companies.¹¹ But for most Canadian manufacturing companies, including many foreign-oriented subsidiaries, the change to an internationally competitive export orientation presents a very profound organizational shock.

The ultimate decision to opt for an internationally competitive stance or to remain focussed on a Canadian market, hopefully with some degree of protection, is a complex one. Such a decision is the product of a range of considerations facing the firm: it depends upon how far the firm judges it is behind the international competition, the age of its capital plant, and its particular financial position. Most importantly, it depends upon whether the management and board of directors are willing to accept the changes and risks inherent in a major reorientation of the firm. There is thus no easy formula to predict how many or which firms will opt for a competitive stance or the status quo, bolstered by more protection. The main point is that the firm's decision is not taken on an industry-by-industry or a sector-by-sector basis, but on an individual basis.

This fact poses problems for policy makers. Most industrial policies and international economic policies are each aimed at a broader grouping of firms, denoted either as a sector or an industry. Such policies are designed for the petrochemical industry, the auto industry, the clothing industry, the footwear industry, and so on. Their underlying assumption is that all firms in a particular group have quite similar circumstances and make the same demands on government policy. In the classic days of the National

Policy, this assumption may have been reasonable; now its validity is somewhat more dubious.

Furthermore, the new environment, in which traditional protective devices such as tariffs have become minimal or inoperative, has the potential to split the conventional groups of manufacturing firms into protectionist and export-oriented groups. This division would also profoundly affect the ability of industry and business associations to represent their members. It has always been a difficult task to achieve a consensus in these groups; now it may become even more difficult for them to agree, especially on the central issue of policies toward trade and protectionism. In all probability, the messages coming from the manufacturing community will be very mixed and contradictory.

And yet those business associations dominated by large multidivisional companies (e.g., the Business Council on National Issues) may obtain a greater degree of consensus than the more broadly based associations. Since they are already all working in an international market, they will want appropriate government policies for their operations. However, by definition such associations will not represent the great range of small and medium-sized businesses, who will be primarily interested in securing the Canadian market.

In the first section of the paper, the analysis clearly suggests that the U.S. market is the primary objective of Canadian manufacturers. A multilateral approach to obtaining access to foreign markets might then be satisfactory if it includes the U.S. market. Such an approach, however, raises a number of serious problems. In the first place, reciprocal access has to be given to the Canadian market, and yet several Canadian industries are more concerned about offshore and Third World competition than U.S. competition. More important, the access constraints are not primarily a matter of formal tariff protection, but are concerned with a range of other constraints and controls in the foreign market. They must also be removed for a long enough period to affect long-term investment decisions of firms, not just their short-term export and sales strategies. To achieve this kind of an agreement on a multilateral basis would be almost impossible.

In all likelihood, therefore, the manufacturing community will favour some kind of arrangement with the United States. However, whatever types of arrangements they may want will probably vary from product line to product line, and from firm to firm, simply because the constraints on access to the U.S. market vary from product to product. For example, some firms would benefit greatly from an exemption from the Buy America acts; some will need regulatory changes in standards and specifications. Others may simply require a dependable, long-term commitment against any new prohibition on access to the U.S. market.

The business community, therefore, is unlikely to address the question of whether possible arrangements with the United States should be of a general and blanket nature, or varied by product group — as long as

whatever arrangements are made provide each major product group with the type of access it requires. These arrangements may not necessarily involve free trade in the classical sense. For example, possibly some tariff protection could continue, although it would be necessary to have the rates bound at an acceptable level. The main criterion is that the arrangements, and whatever remaining safeguards that are needed, must be firm and dependable.

Organized Labour

Organized labour has become one of the institutions that has greatly influenced public policy in the past four decades. Although labour was an important factor in many industries prior to 1940, and was concerned about policies affecting those industries, the full maturation of the Canadian labour movement has been achieved only in the postwar period. With this maturation, it has played a much more direct political role and developed positions on a number of public policy issues.

The prewar traditional labour movement was dominated by the trade and industrial unions. As might be expected, these unions were deeply concerned with the economic health and viability of the sectors or industries for which their members worked. Some of the resource industries had strong unions, but the majority, especially the largest, were found in the secondary manufacturing industry and the transportation system supporting it. The interests of the union movement were thus largely complementary to those of central Canada and the manufacturing sector. Tariff protection and border restraints were as important to them as they were to the employers. For international economic policy at least, the traditional unions and central Canadian industries comprised a fairly solid bloc of interest.

Several developments, however, have worked to erode such complementary interests in the last decade. One major factor has been the changed composition of the union membership. The unionization of large sections of the public sector has brought into organized labour public service workers, teachers, health workers, maintenance workers, postal workers, and many others. In the private sector, the unionization of such service industries as distribution and retail trade is only now being pursued vigorously (see table).

Although these new unionists have common ground with traditional labour on many issues such as wages, hours of work, safety, and a range of fringe benefits, there is one important area where they differ. By and large, the newer unions do not compete with foreign sources of supply for the products or services which they provide. Neither they nor their employers have to be internationally competitive. On issues of international economic policy, therefore, their views may possibly seriously differ from those held by the traditional industrial unions.

Union Membership by Trade Sensitivity

	1966	1970	1975	1980	1981	1982
	(percent distribution)					
Trade sensitive ^a	44.4	38.2	33.9	31.7	30.9	27.9
Non-trade sensitive	54.8	60.1	64.8	67.0	67.7	70.4
Commercial and service ^b	(39.7)	(46.1)	(48.3)	(50.7)	(51.6)	(53.7)
Public administration	(15.1)	(14.0)	(16.5)	(16.3)	(16.1)	(16.7)
Other ^c	0.8	1.7	1.3	1.3	1.4	1.7
Total union membership	100.0	100.0	100.0	100.0	100.0	100.0

Source: Corporations and Labour Unions Returns Act, *Annual Report, Part II-Labour Unions*.

a. Includes manufacturing, mining, forestry and from 1970, agriculture and fishing.

b. Includes transportation, communication and other utilities, construction, trade, service industries and, from 1970, financial services.

c. Includes pensioners, unemployed, etc.

This divergence of views could take place in two main policy areas governing wages and tariffs and trade. In the case of wage policy, unions in internationally competitive lines of activity will be under enormous pressure to keep their wage demands down and preserve their jobs. Their counterparts, however, will not feel the same sharp constraints of international competition and are more likely to bargain for higher increments. If the latter groups' negotiations are successful, they will create tensions within the union movement and industry and promote the maintenance of wage relativity. Under these circumstances, the only way to counter the upward pressure on wages in internationally sensitive industries would be to accept a gradual decline in the exchange rate, which would have the effect of spreading the real cost of the wage increases over the whole of the union movement and the economy.

The second divergence of views could take place on tariff and trade policy. Industrial unions, on the one hand, have a direct and critical interest in changes at the level of border protection. They are normally concerned about increases in the access of foreign products to the Canadian market. On the other hand, unions not sensitive to international competition have little such interest. Indeed, in many ways the interests of these union members might be furthered by a more open trade environment. Particularly for those in the distribution and service industries, foreign goods present the same employment opportunity, or even a greater one, as domestic goods. Furthermore, as consumers, they are interested in obtaining more low-cost goods. It is not clear, therefore, how these newer union members will affect the policy of the Canadian labour movement toward international economic issues. At a minimum, they might choose to submerge their own interests in trade policy so as to adopt those of the industrial unions. At

the other extreme, they could precipitate a debate that would place further strains on the unity of the labour movement in Canada.

Similarly, the cost dynamics that have been described as particularly relevant to the manufacturing community can be expected to affect the attitude of unions within this sector to international economic policy. One might anticipate that these members will support their employers' position on international economic policy. If certain manufacturing firms that are unable to confront or adapt to new competitive conditions advocate the continued protection of their industries, their unionized workers might likewise endorse the same position. In such a case, these firms, unions and their respective communities would represent solid blocs of pressure in favour of protectionism, thereby maintaining the same position adopted by many firms, unions, and small and medium-sized businesses in Canada.

In contrast, the position of those unions situated in firms opting for an internationally competitive stance would likely be more complex. At one level, the prospect of an internationally viable firm, which seemingly offers job opportunities, would lead union members to support, or at least tolerate, the changes in international economic policy required for this adjustment. But at another level, two other factors would tend to counter such support. In the first place, the evolution toward competitiveness is likely to lead to a loss of jobs in such firms. In a few cases, the expansion in output might be adequate to maintain or even increase employment; in most cases, however, a net loss of jobs is more probable. Even in cases where employment may increase, the newly created jobs are likely to involve quite new tasks, requiring either extensive retraining of present employees or hiring new employees with different skills. In either case, the unions concerned will not be comfortable with the changes.

Union solidarity is a second important factor influencing policy changes. Usually unions do not speak on a plant-by-plant or local-by-local basis. Seldom is one local large enough to dominate a union position. Yet the employer position on foreign economic policy may well be determined on a firm-by-firm basis, as we saw earlier. Thus individual firms and their employees may not agree on this issue.

Furthermore, the labour position on foreign economic policy has tended to be articulated more and more by such federations as the Canadian Labour Congress. To whatever extent possible, these central groups have to try to articulate the consensus reached by their constituent unions. Thus, the particular interests of constituent unions or locals will be muted by the time the messages reach the government. The point remains that certain groups of industrial union members may nevertheless see their own interests best served by a more open trading system.

The reaction of labour to technological change and to trade policy will also depend upon the rate at which employment can be created in the economy. A reasonable rate of employment growth, creating alternative job openings, will allow labour to take a much more flexible position on

both technological change and international trade issues. Good employment growth rates would still leave the labour movement with major adjustment problems of great concern, but nevertheless give them some room in which to resolve these problems.

The interests of organized labour are therefore likely to continue to exert considerable influence on Canadian international economic policy. As in the past, the dominant interests will be articulated in central Canada and voiced before the governments of Ontario and Quebec, and the federal government. The future policy statements of the labour movement, however, may not be quite as unanimous as in the past. The growth of union membership in the public sector and in service industries provides the potential for a different set of attitudes and priorities toward international economic policy. Protection from imports, therefore, will not be as central an issue for the public sector and service unions as it is for industrial unions. Furthermore, even the industrial unions may adopt different concerns regarding trade policy as each union and the associated sector or firm assesses its chances of adapting to new technology and meeting international competition. The pressures and constraints emanating from the labour movement may thus be more difficult to interpret in the future than in the past.

The Provincial Governments

Over the past two decades, the views of provincial governments have had an increasingly important influence on the formulation of Canadian international economic policy. There are a number of reasons for the growth of provincial influence. First, the provincial bureaucracies have simply improved their capacity to analyze the provincial situation, develop a position and then articulate it vigorously. Second, the increased wealth and tax bases of some of the provinces have permitted them to initiate significant industrial policy initiatives of their own. Given the dependence on exports of most provincial economies, they could not carry out these industrial policy objectives without an appropriate trade and international investment policy. As a result, the provinces demanded and achieved an effective role in the development of the Canadian position on the Tokyo Round of tariff negotiations. More importantly, their participation in that exercise developed their capacity to participate in the discussion of international economic policy available to them in the future.

At the same time the provinces were developing their capacity to involve themselves in international economic policy, their interests regarding that policy were undergoing subtle but significant changes. The traditional position of the provinces could be described in this oversimplified manner: the two central provinces of Ontario and Quebec were basically protectionist, reflecting their manufacturing base, while the other provinces tended to favour free trade, reflecting their resource-based and export orientation.

The kinds of pressures brought to bear during the Tokyo Round still tended to reflect this dichotomy. But there were some interesting nuances. Some of the provinces, such as British Columbia and Alberta, began to have more ambitions about resource upgrading and industrial diversification, and consequently became more guarded in their demands for a more open international trading system. On the other hand, the rapid changes in the cost position of the manufacturing industries, as set out in the first part of the paper, made the position of the central provinces a little less adamant than it might have been.

Moreover, the position of Ontario and Quebec regarding international economic policy is likely to continue to become more equivocal. As the viability of more and more of their constituent firms depends on gaining access to larger contiguous markets outside of Canada, these two provinces are likely to become more amenable to trade arrangements favouring such access. The experience of the Auto Pact, while not completely satisfactory, has nevertheless set a reasonably satisfactory precedent. This situation suggests that further arrangements of some kind may be useful.

However, a large number of firms in both provinces will continue to want some form of protection. They will likely be supported by major segments of the union movement. These pressures will also be brought to bear on the provincial governments. Given the tendency for small and medium-sized older industries to be located in smaller centres in both provinces, the political sensitivity will remain high. Clothing, footwear, and furniture industries, as well as many types of small manufacturing, are located outside of the major urban areas. Their political pressure will be great.

Thus, both the protectionist and the open-economy policies are likely to be pressed vigorously on the Ontario, Quebec, and federal governments. The two approaches will be difficult to reconcile. Moreover, the debate will focus primarily around international economic policy, especially with the United States. Government policies addressed at improving domestic investment, training the labour force, and incorporating modern technology are largely compatible with the interests of all industries, unions and sectors. The sharpest differences, however, will arise over the approach to trade and international economic policy: it is in this context that the debate over the character of Canadian economic development is likely to take place.¹²

Conclusions

The analysis in this paper postulates that three main institutions in Canada will bring influence and pressure to bear on the federal government as it formulates international economic policy over the next decade. These three institutions include the Canadian business community, the labour unions, and the provincial governments. All three institutions have long

played an important role in the evolution of Canadian international economic policy. What is new is their altering perception of their own interests. Thus, the nature of their demands on Canadian policy makers may change.

The impetus for these changes has come from two main sources. First, the international environment has become more competitive, as a result of a decline both in the levels of tariff protection, and in the cost of transportation. Second, technology, high capital costs, and rapid changes in product and process technologies have led business managers to assess investment decisions in new ways. This new form of evaluation is particularly appropriate to secondary manufacturing, because it greatly emphasizes the ability to increase the volume of output rapidly, and thus the availability of a substantial market. This development will increase the pressure for some type of association with a larger market, particularly the United States.

The new style of evaluation, however, will not be universal in the business community; as a result, its views on international economic policy will likely be more fractured. The differing interests of their employing firms may also affect the views of industrial unions, although union solidarity may possibly mute such differences. More important for the labour community is the growing unionization of large numbers of workers in both the private and public sector, who are not directly competitive with foreign labour and who may not be as strongly associated with protectionist policies as industrial unions.

Ontario and Quebec will probably be most influenced by the evolution in the attitudes of business and labour. Other provincial governments may be expected to continue to advocate a more open trade policy to reflect the main interests of their economic base. Their calls for free trade may be somewhat muted by their own growing industrial ambitions, which is unlikely to change their dominant position. The governments of Ontario and Quebec may be put under conflicting pressures for open trade arrangements with the United States. Their positions may be equivocal.

Because of the dominance of Ontario and Quebec in the national economy, the federal government cannot fail to be affected by the conflicting pressures coming from the manufacturing sector of the two provinces. On balance, the new interest of some manufacturers in wider marketing arrangements might be expected to strengthen the arguments for more open trade arrangements in Canada. But the degree of industrial adjustment implied by more open trade arrangements will be very large and widespread. This factor is enough to ensure that the process of formulating international economic policies appropriate for the long-term future of Canadian manufacturing will be neither easy nor quick.

Notes

This paper was completed in December 1984.

1. See James R. Melvin, "The Regional Impact on Tariffs," and Ronald A. Shearer, "Regionalism and International Trade Policy," in *Canada-United States Free Trade*, volume 11 of the research studies prepared for the Royal Commission on the Economic Union and Development Prospects for Canada (Toronto: University of Toronto Press, 1985).
2. See J. Finlayson, "An Analysis of Canada and the International Political Economy" (Ottawa: Business Council on National Issues); See M. Webb and M. Zacher, "Canadian Export Trade in a Changing International Environment," in *Canada and the International Political/Economic Environment*, volume 28, and G. Hufbauer and A. Samet, "U.S. Response to Canadian Initiatives for Sectoral Trade Liberalization, 1983-84," in *The Politics of Canada's Economic Relationship with the United States*, volume 29 of the research studies prepared for the Royal Commission on the Economic Union and Development Prospects for Canada (Toronto: University of Toronto Press, 1985).
3. One estimate the Department of Industry, Trade and Commerce made during the response to the crisis in the Canadian colour TV industry in the mid-1970s suggested that a tariff level of 75 percent would barely suffice to keep out foreign TV sets and protect the Canadian market.
4. Canada, Department of Employment and Immigration, *Labour Market Development in the 1980's* (Ottawa: Minister of Supply and Services Canada, 1981), pp. 62-64.
5. Canada, Ministry of State for Economic Development, "The Medium Term Economic Outlook for Industries and Provinces," unpublished (Ottawa: February, 1981), pp. 45-50.
6. Some observers of the Canadian industrial scene tend to classify Canadian industries and firms into "traditional" and "modern" sectors. They suggest that a discussion of Canadian industrial policy should hinge around this distinction. It is not clear to the author that such a distinction is helpful. Some industries or firms may choose to operate in a "modern" fashion, while some choose to operate in a "traditional" fashion. But it is not obvious that firms are bound by the inherent nature of their business to be in one group or the other.

The classification into traditional or modern categories tends to be based on the nature of the products produced by the firm. Standard basic products of either a resource or manufactured nature are produced by "traditional" firms, while new products of complicated manufacture and design come from "modern" firms. In fact it is possible, and even critical for Canada, to have modern, high-technology firms producing standard products. Anyone who has visited the CDC-owned smelter at Timmins, Ontario will understand this point. A major part of the smelter is a huge room that contains bubbling vats of ore going through chemical processing. At the centre of the room is an enclosed computer area in which assays of the ore mixture being processed in each vat are recorded every few minutes. The chemical mixture in each vat is then adjusted automatically to accommodate the change in the quality of ore going through. The improvement in the recovery rate over that in less modern plants is significant. The Timmins plant was at the leading edge of technology when constructed, though all that comes out at the end are ordinary ingots of lead, zinc and copper. Yet surely here is a modern technology and a "modern" firm.

The same point can be made about sawmilling where a micro-computer analysis of each log can determine the most efficient pattern to process the log and thus improve the yield and productivity of sawmills. Again, advances in plant breeding over the past twenty years means that wheat, soya beans, and other basic grains are, in essence, high-technology products now, even though they look the same as in the past. It is precisely because Canada has a large number of "traditional" resource and manufacturing industries in existence that the diffusion and adaptation of modern process technology is so important for the Canadian economy. It is through adaptation that traditional firms are converted into modern ones. Therefore, an analysis of industrial policy based on a classification into traditional and modern sectors may be more misleading than helpful.

7. Harvard Business School, *Note on the Use of Experience Curves in Competitive Decision-Making* (Boston, Mass.: HBS Case Services, Harvard Business School, 1975).

8. Ibid., p. 10.
9. There is a growing body of literature on the strategies of multinationals. For a recent work, see David Rutenberg, *Multinational Management* (Waltham, Mass.: Little, Brown, 1983). Chapter 7 is particularly pertinent to the argument here.
10. Northern Telecom, *Annual Reports*.
11. Canada, Department of External Affairs, *Canadian Trade Policy for the 1980s* (Ottawa: Minister of Supply and Services Canada, 1983). See especially pages 22 to 27 for the reflection of the mixed response of the manufacturing industries.
12. Ibid.



Canadian Defence and Defence Procurement: Implications for Economic Policy

R.B. BYERS

An Overview

During the 1970s and into the 1980s Canadian defence issues were not high-priority items on the public policy agenda. This was a departure from the earlier post-World War II period, when defence had emerged as an important public policy issue on a number of occasions. Canadian involvement in the formation of NATO, in the Korean War, in defence relations with the United States, and as a leader in international peacekeeping operations reflected a high degree of government interest in defence during the late 1940s and the 1950s.¹ In the early 1960s nuclear weapons dominated the defence debate² and later in the decade the unification debate emerged as a controversial public policy issue.³ With the completion of the 1968–69 foreign and defence review, however, defence issues for the most part assumed less prominence.⁴ At the end of the Trudeau era in late 1984, for example, Canadian defence policy remained based on the 1971 defence white paper.

By the early 1980s, however, it had become apparent that the time for a thorough review of Canadian defence policy had arrived. Not only had the international climate deteriorated during the late 1970s, but an increasing number of criticisms regarding Canadian defence objectives, commitments and capabilities had surfaced. Parliamentary and private sector reports alike called attention to the need for the government to reassess the basis of Canadian defence.⁵

By late 1983, therefore, defence had become a significant public policy issue.⁶ The Mulroney government has committed itself to allocate greater resources to the defence sector, to increase Canadian military capabilities and to honour Canada's commitments to the Western Alliance.⁷ A 1985 Conservative defence white paper should outline Canada's defence objectives, commitments, activities, and defence spending.

Irrespective of specific objectives, commitments and activities, the allocation of resources to the defence sector raises important and possibly controversial policy choices. Important linkages exist between the level of defence spending and the capability of the Canadian Forces to fulfill commitments specified by the government. Defence resources are significant in terms of the implications for current and future capital programs, the regional impact of the defence dollar allocated to pay and personnel as well as to operations and maintenance, and the future development of Canadian defence-related industries.

Analyses of the economics of defence in Canada are few,⁸ and studies that discuss the economic implications of defence procurement are virtually nonexistent.⁹ However, the economics of defence can be analyzed from a number of perspectives.

One approach would be to focus on the defence procurement/economic policy relationship per se, examining governmental, military and industrial interfaces in order to assess the economic factors that affect policy choices for defence, including defence procurement. Such an approach would explain why and how the government's economic policies influence defence procurement, and would analyze the economic parameters within which Canadian defence policy is formulated and implemented. It could, in the first instance, stem from a macroeconomic analysis of the Canadian economy and, more particularly, from an analysis of government economic policy and total government spending and priorities.¹⁰

A major difficulty with this approach, however, is the assumption that economic considerations should assume greater importance than defence as such in shaping Canada's defence policy. It could be argued, of course, that during the Trudeau years economic factors more than military-strategic assessments of defence requirements shaped the size, structure and capabilities of the Canadian Forces.¹¹ Similarly, there are grounds to argue that resource allocations for defence, especially for capital procurement, have been structured in an attempt to maximize regional and industrial development.

Nevertheless, a defence-as-economics model for the analysis of resource allocation has serious limitations. Most important, it could unduly shape Canada's national security requirements to conform to the economic parameters deemed important by government and, in the process, detract from the ability of the Canadian Forces to fulfil their commitments.

An alternative approach, and the one adopted in this report, is to place the resource allocation issue within the broader military-strategic context and, in the first instance, to assess Canadian defence requirements within the framework of objectives, commitments, and capabilities. This approach makes it possible to address Canadian defence in terms of commitment-capability relationships.¹² From the perspective of resource allocations, the government can then *either* alter commitments in light of existing resources — which can be translated into capabilities — *or* alter the

resource base in order to meet commitments deemed essential to Canadian (and Western) security. This approach presumes that the major purpose of defence expenditures is to purchase Canadian security and, given Canada's participation in NATO and NORAD, to purchase Western security.¹³

The commitment-capability approach to Canadian defence allows the government to take into account the economic realities of overall governmental and defence-related economic resources. It may also ensure a better balance between commitments and capabilities. Deterrence credibility requires, in part, that roles and missions assigned to the military can be fulfilled in an adequate manner.¹⁴

In order to address the economics of defence from this perspective, it is important, first, to assess Canadian defence in terms of commitments and capabilities, given the current and projected military-strategic environment. The next section outlines defence objectives and security threats, and then turns to commitment-capability linkages, thereby providing a framework from which to assess historical and current defence expenditures in order to ascertain whether sufficient funds are being allocated to defence. In part, the following section addresses these issues and offers further options for future defence funding.

At this stage of the analysis, various economic considerations related to defence allocations could be pursued. One option would be to assess the connections between defence spending and the socio-economic effects of the defence dollar on specific industries, on employment opportunities, and on regional and national economic growth. For example, studies undertaken by the Centre for Studies in Defence Resources Management¹⁵ at the Royal Military College of Canada have made distinctions between three types of economic impact: direct, indirect and induced. The pay and allowances of military and civilian Department of National Defence employees have a direct impact on the Canadian economy. An indirect impact occurs as a result of procurement, operation and maintenance expenditures, which generate productive activity and income in other parts of the Canadian economy, including additional wages and salaries, unincorporated business incomes and corporate profits. The direct and indirect impacts of defence spending constitute the total economic impact of defence expenditures in Canada. The impact of the re-spending of defence sector incomes accounts for the induced impact. This is a useful approach and it is to be hoped that further studies are forthcoming.

Another option, and the one adopted in this report, is to address issues related to the procurement of defence equipment more directly. This option involves analyses of defence-industrial relationships from the perspective of the capital component of the defence budget. It also focusses on the translation of defence capital resources into specific procurement programs for the Canadian Forces.

Defence-related expenditures and programs constitute nearly one-half

of total federal capital expenditures, and for this reason the defence sector should offer government and industry an opportunity to interact in a mutually supportive manner. Issues related to defence procurement are, however, complex, and involve foreign as well as domestic considerations.¹⁶

The involvement of industry in the defence sector is, in part, a function of government procurement options, the financial resources available for capital programs, and the degree to which defence procurement is pursued on a consistent and sustained basis. These issues are addressed in the sections on defence expenditures and defence procurement.

Canada's defence-related industries have, in the main, developed in response to export potential — particularly vis-à-vis the United States — rather than in response to Canada's defence requirements. Only in recent years have serious attempts been made to link Canada's industrial base more closely to national defence requirements. The section on defence industries offers an overview of the industrial defence sector, including the defence market, and looks specifically at the aerospace and shipbuilding sectors.

In terms of the future evolution of Canadian-based defence industries, a number of important issues arise given the economic implications of defence procurement. A major purpose of this report is to analyze the relationships between government policy on the one hand and defence industries on the other. The sixth section outlines some of the difficult policy choices relating to the industrial defence base, the government's defence procurement strategy, military research and development, the future of the Defence Production Sharing Agreements (DPSA) with the United States, and the role of industrial benefits and offsets within the context of defence procurement programs.

The analyses contained in this report address the implications for economic policy of defence procurement, while taking into account the broader military-strategic context of Canadian defence policy. The report recommends ways in which government and industry can interact in order to utilize defence resources more fully for the security of Canada and, at the same time, develop Canada's industrial base.

Canadian Defence: Military-Strategic Perspectives

In the post-1945 era Canadian defence policy has been influenced and shaped by two major trends that have tended to run counter to each other. One trend reflects consensus and consistency by successive Canadian governments — Liberal and Conservative — regarding the underlying principles, basic objectives, and principal activities of Canadian defence and the Canadian Forces. The second trend reflects confusion, inconsistency and dissent in terms of threat perception, the priority attached to defence

activities, the allocation of resources to defence, and the requirements for related re-equipment and modernization.

These opposing trends, which have been apparent for some 30 years, have produced a significant gap between defence commitments on the one hand, and defence capabilities on the other. The Canadian Forces do not possess sufficient military capabilities to meet the range of commitments declared by the government to be in the interests of Canadian security. Since the mid-1970s Canadian governments have attempted, at least in part, to rectify this commitment-capability gap, but with limited success.

The basic principles that have consistently guided Canadian defence policy can be traced to Prime Minister St. Laurent's Gray lecture delivered at the University of Toronto in January 1947.¹⁷ Since the late 1940s, successive Canadian governments — Liberal and Conservative — have pursued four major defence objectives: first, to foster collective self-defence by Canadian participation in NATO; second, to defend the continent in partnership with the United States; third, to maintain peace and security through the United Nations, especially by participation in international peacekeeping operations and the pursuit of arms limitation; and fourth, to protect and enhance Canadian sovereignty through national measures.

In one form or another, these objectives have formed the central core of the Conservative defence paper of 1959, the Liberal defence white papers of 1964 and 1971, and of the annual reports of the Department of National Defence since the mid-1970s.¹⁸

Defence Priorities and the International Environment

While the basic principles and objectives of Canadian defence have remained consistent, there have been numerous changes and shifts in the relative priority allocated to defence objectives.¹⁹ It should be acknowledged that priorities can be expected to change, given the range of factors, both external and domestic, which affect defence considerations.

Prior to the mid-1960s, Canadian defence priorities were oriented (in descending order of importance) toward NATO, NORAD and international peacekeeping, even though no explicit attempt was made to rank these defence activities.

The first official attempt to order defence activities systematically was the 1964 defence white paper, wherein participation in NATO and Canadian contributions to international peacekeeping received equal priority.²⁰ No emphasis was placed on defence activities relating to the protection of Canadian sovereignty, nor did the white paper explicitly link defence and deterrence with arms control and disarmament.

Prime Minister Trudeau initiated the 1968–69 foreign and defence policy review, based on his premises that Canadian policy had become Euro-centric and placed undue emphasis on NATO, and that defence policy circumscribed

foreign policy. The most important and long-term result of the review was the decision to reduce the Canadian Forces contingent in Europe. This was a clear departure from the priorities of the 1964 white paper and more than any other decision indicated a shift in defence activities, even though other NATO commitments were agreed upon at that time.

The 1971 defence white paper confirmed the downgraded priority allocated to NATO and expressed considerable skepticism concerning future participation in international peacekeeping operations. In place of these priorities, greater emphasis was placed on the protection of Canadian sovereignty, which included internal security, along with defence cooperation with the United States.²¹

By 1973, however, NATO had re-emerged as a defence activity of increasing importance. This was the result of changing perceptions of the international environment as well as of pressure from Canada's NATO allies. Since the mid-1970s and into the 1980s, Canadian defence priorities have focussed primarily on participation in NATO and then on defence relationships with the United States.

The changing emphasis on the priority allocated to defence activities can be explained partially by the lack of consensus regarding threats to Canadian security. One view starts from the proposition that there is no direct and separate military threat to Canada. This approach argues that geo-strategically the United States and Canada are contiguous regions and any attack on Canada would constitute an attack on the United States, and that the development and deployment of nuclear weapons has all but eliminated the probability of a direct conventional military attack against the North American continent. From this perspective, the American nuclear umbrella provides for the security of Canada. Finally, the United States is primarily responsible for North American defence and will take whatever security measures are deemed appropriate. Given this set of propositions, basically correct in themselves, it can be argued that Canada's defence requirements are minimal. In its more extreme form, the logical extension of this line of reasoning is for Canada to opt for a free ride vis-à-vis the United States and/or become a neutral state.²²

Alternatively, it can be argued that the above propositions fail to take into account the fact that Canadian security is primarily a function of the soundness and effectiveness of American national security policy. Moreover, given the nature of the Western Alliance and the interrelationship between American and European security, Canadian national security depends on the extent to which a credible military deterrent exists in Europe. In the final analysis, European security relies on the viability and credibility of American deterrence, including nuclear deterrence. This being the case, Canadian and European security become intrinsically intertwined.

Canadian defence becomes extremely complex, because it must take into account both American and European concerns for security. When NATO consensus is the order of the day, Canadian defence concerns are less likely

to become major issues. Thus, during the early 1970s, the pursuit of international security by the two-stream approach of defence and détente, as advocated by the Harmel report, became the cornerstone for Canadian policy. With the breakdown in détente and the deterioration of East-West relations, however, Canadian perceptions of the international environment assumed greater importance in terms of how and to what extent Canada should attempt to contribute to international peace and security. Since the late 1970s, the government and members of the attentive public have expressed greater interest in the management of East-West and superpower relations.²³

In a general sense, Canada's defence activities have been influenced by perceptions of threat. The 1964 defence white paper placed considerable emphasis on regional instabilities and the necessity to contain Soviet expansionist tendencies. The 1971 defence white paper, however, offered a more benign view of the international environment, given the emergence of détente.

By the mid-1970s the euphoria of détente had begun to diminish and Canadian perceptions reflected the new reality. The factors relating to changed perceptions of the international environment²⁴ are well known: the failure of SALT II, the Soviet invasion of Afghanistan, instability in Poland, the election of the Reagan administration, leadership changes in the Soviet Union, the continued military build-up by both superpowers, the American invasion of Grenada, the unstable situation in the Persian Gulf, and the Middle East situation. The list goes on.

Despite changing perceptions of the international environment, which are entirely warranted, successive Canadian governments since the late 1950s have consistently expressed concern about the dangers of nuclear war and the appropriate Canadian contribution to deterrence. This perception continues today; as *Defence Estimates 1984/85* states, "Nuclear war will pose the greatest threat to Canada's survival for the foreseeable future."²⁵ Nevertheless, there has been little consistency in terms of the specifics of Canada's response to this threat. The nuclear debate of the early 1960s and the confusion within the Diefenbaker government on how to cope with the nuclear issue is the most appropriate historical example.

One of the current major policy issues is how to integrate defence policy with arms limitation policy. Segments of the general public perceive the government as pursuing defence policy independently from arms limitation policy. These perceptions stem, in part, from Canada's decision to allow tests of the air-launched cruise missile. This position has been deemed inconsistent with Mr. Trudeau's speeches to the first and second United Nations Special Sessions on Disarmament, which outlined proposals to suffocate the nuclear arms race. The Liberal government argued that Canadian policy could not be implemented unilaterally, but large segments of the Canadian public have remained troubled by the perceived inconsistencies of government policy.²⁶

Prime Minister Trudeau's peace initiative attempted to address public concerns and to reassure the general public that the Canadian government remained committed to restoring the dialogue in East-West relations.²⁷ However, neither the peace initiative nor Liberal defence policy addressed, from a Canadian perspective, the military-strategic requirements to ensure the stability and credibility of deterrence.²⁸

During the 1980s the international environment has become more fragile and less stable. The current climate suggests that Canadians are likely to go through a period when they will perceive that they are getting less security at a higher economic cost.²⁹ This being the case, Canadian governments must be willing to undertake the active pursuit of measures that can contribute to international peace and security. The major requirement is for strong political leadership directing sound diplomacy in order to moderate East-West tensions and come to grips with the nuclear arms race.

While the Canadian approach to world problems should be primarily political, it is also essential to have military credibility. Canada should meet its obligations to Western security in an appropriate manner. Allies and potential adversaries alike should understand and appreciate that Canada maintains armed forces to contribute positively to the credibility of mutual deterrence, to enhance international stability by peacekeeping, and to protect Canadian interests. Without military credibility the Canadian government's ability to exercise influence with the United States, within NATO and the United Nations, and even with the Soviet Union and Eastern Europe is circumscribed.

The Commitment-Capability Gap

The priorities allocated to Canadian defence in the past have been reflected by changes in commitments and in military capabilities.³⁰ The following factors have influenced the relationship between commitments and capabilities: the nature of the international environment, including active Canadian involvement in hostilities; negotiations with and requests from NATO and the United States; United Nations and American requests for participation in international peacekeeping operations; and the range of domestic factors and considerations that have influenced Canadian defence.

Within the last several years, considerable attention has been centred on the gap between Canadian defence commitments on the one hand and defence capabilities on the other. Within NATO, only American commitments are more extensive in terms of geographic scope, and roles and missions. Canadian commitments to NATO and Western security are excessive and unrealistic given the current size and capabilities of the Canadian Forces.³¹

With the exception of the northern-flank role, Canada's commitments to Western security have been largely the same since 1949; however, the means by which Canada seeks to fulfil these commitments have been

decreased since the mid-1960s, when the size of the Canadian Forces was reduced from 126,000 personnel to the current level of some 82,000 regular and 21,000 reserve force personnel.

The single most significant change occurred in the early 1970s, when the Canadian Forces in Europe were reduced by half to the current level of some 5,000 personnel. The land element, 4th Canadian Mechanized Brigade Group, was withdrawn from a forward defensive position on the central front and reconfigured as a strategic reserve. At the same time, however, the government agreed to the CAST (Canadian Air-Sea Transportable Brigade Group) commitment to Norway and to the contribution to the Allied Command Europe Mobile Force from units based in Canada and Europe. It is somewhat ironic that the attempt to restructure Canada's contribution to NATO actually led to an expanded set of commitments, but with fewer resources and reduced manpower.

The deficiencies of the Canadian Forces have been the focus of a series of reports completed by the Senate Committee on National Defence. *Manpower and Canada's Armed Forces*³² concluded that serious manpower deficiencies exist within the Canadian Forces and that regular strength should be increased to 91,800, and that 6,000 of these personnel should be allocated to Mobile Command in order to augment Canadian land force capabilities in Europe. The May 1983 report, *Canada's Maritime Defence*, noted that, with its present forces, Maritime Command, "which is responsible for the country's seaward defences, cannot meet its commitments to the protection of Canadian sovereignty, to the defence of North America, much less to NATO."³³ The January 1985 report on Canada's air defence requirements and capabilities concluded that serious deficiencies also exist in this area.

The Trudeau government acknowledged belatedly that a commitment-capability gap existed, and the current Conservative government concurs with this assessment. Government concerns about the ability of the Canadian Forces to fulfill commitments stem from the Defence Structure Review of 1975.³⁴ The Defence Structure Review initiated Canada's re-equipment plans for the Canadian Forces and led to increased capital expenditures for defence. This was followed by concurrence to meet NATO's request for a target of 3 percent real growth in defence for the five-year period from 1978 through to 1983-84. The current re-equipment program (see the procurement section) will redress some of the major capability deficiencies, but the present level of capital allocations appears insufficient to meet existing commitments.

From a military-strategic perspective, concerns have been expressed that Canada is not making an adequate contribution to conventional deterrence.³⁵ This problem will be aggravated even further unless adequate resources are provided on a sustained basis. Given the economic situation facing the Conservative government, it may be unrealistic to expect that the defence budget can be increased substantially. However, the present

status quo is unacceptable, and a more reasonable balance between commitments and capabilities must be pursued.

Any reassessment of commitments must take into account the political implications of existing and proposed commitments, the extent to which Alliance commitments are congruent with and serve other Canadian defence interests and objectives, the military viability of commitments given the Canadian Forces structure and equipment, the effects of changes on military professionalism and training as they affect operational effectiveness, the economic costs, and the degree of public acceptance.³⁶

A review of Canadian defence policy and problems relating to commitments and capabilities is the first step in ascertaining the extent to which resources should be allocated to defence. The government's equipment acquisition program and the Canadian defence industrial base can then be placed within the appropriate national security context. Economic resources for defence should, in the first instance, serve to enhance Canadian security, and only then be directed toward other objectives.

Defence Expenditures: The Allocation of Resources

Resource allocations by governments to various policy sectors generally raise a wide range of issues and competing demands both within and outside of government. Defence is no different from other sectors such as education, health, and communications, in that the government allocates resources to defence within the context of overall governmental and societal priorities.

However, defence purchases national security, a commodity often impossible to quantify. In times of peace, it is difficult to construct a direct correlation between the level of defence spending and the degree of security purchased. In other words, neither increasing nor decreasing the defence budget necessarily has any appreciable impact on Canadian national security.³⁷

The difficulty of stating Canadian national security in dollar terms can be linked to a number of factors. First, the major threat to Canada is the danger of a nuclear war between the superpowers; but Canada, as a non-nuclear state, is not in a military position to defend itself unilaterally against the nuclear threat. Second is Canada's role in the Western Alliance. Military interdependence through NATO and NORAD raises the question of burden-sharing and Canada's share of collective self-defence. Third, the major purpose of military force is for deterrence, and deterrence credibility is only partially a function of resource allocation. Fourth, Canada participates militarily in the Western Alliance — at least in part — to acquire a voice in the councils of the West; again, no specific defence dollar value correlates with the acquisition of political influence.

Nevertheless, it is possible to translate Canadian defence spending into

more tangible criteria. At a minimum, resources must be sufficient to protect Canadian interests, particularly sovereignty interests. Canada has also accepted specific commitments to the Western Alliance and has an obligation to fulfill these commitments in a manner that enhances deterrence credibility. In addition, Canada has agreed to maintain forces for international peacekeeping under the auspices of the United Nations.

Defence spending can also be translated into domestic economic criteria. First, part of the defence dollar is allocated for pay and personnel, which has an impact on the national economy. Second, defence allocations for operations and maintenance mean that Canadian goods and services are utilized. Third, capital acquisitions can have a significant effect on defence-related industries located in Canada and abroad. However, the regional effects of defence allocations can vary considerably. Some regions of Canada, for example, the Maritimes, are more reliant on defence spending for their economic well-being than others.³⁸

In Canada, the allocation of resources for defence has often been controversial. A wide range of arguments has been adopted to either bolster or refute the case for defence spending.³⁹ This being so, it is important to assess defence spending in its historical context, to address government approaches to defence spending, and to outline the current defence expenditures plan within the context of the range of funding options for future allocations.

Defence Expenditures: Historical Trends

Defence expenditures can be analyzed from a number of perspectives, and rather different conclusions can be reached regarding the appropriateness of government allocation decisions. This section assesses defence expenditures within the context of overall government spending, and analyzes Canada's financial contribution to the Western Alliance.

A comparison of federal expenditures against defence spending allows for an assessment of the priority governments have historically allocated to defence. Table 5-1 compares overall federal and defence expenditures since fiscal year 1950-51 and shows that federal expenditures increased in current dollars in every fiscal year except 1954-55, even though the rate of change has varied considerably. From 1953-54 through to 1965-66 federal expenditures increases were modest, but picked up between 1966-67 and 1972-73. For the next three-year period the budget expanded more than 25 percent per year. Since 1978-79 the percentage growth has varied from a high of 19.1 percent in 1980-81 to a low of 3.6 percent in 1984-85. The low growth pattern can be expected to prevail under the Mulroney government given the commitment to reduce the federal deficit, in part by reducing expenditures.

TABLE 5-1 Total Federal and Defence Expenditures, 1950-51 to 1984-85

Year	Federal Expenditures		Defence Expenditures		
	\$ millions	Current % change	\$ millions	Current % change	Real % change
1984-85	94,554	+ 3.6	8,767.0	+ 10.0	—
1983-84	91,254	+ 16.6	7,972.2	+ 14.0	—
1982-83	78,276	+ 8.9	6,991.1	+ 16.0	+ 3.3
1981-82	67,959	+ 8.9	6,027.7	+ 18.7	+ 2.8
1980-81	62,377	+ 19.1	5,077.1	+ 15.7	+ 1.5
1979-80	52,364	+ 11.6	4,389.3	+ 6.8	- 1.9
1978-79	46,923	+ 9.4	4,108.0	+ 8.9	+ 0.5
1977-78	42,882	+ 10.1	3,771.0	+ 11.9	+ 2.4
1976-77	38,930	+ 17.3	3,371.2	+ 13.4	+ 0.9
1975-76	33,181	+ 27.3	2,973.7	+ 18.4	+ 3.2
1974-75	26,055	+ 29.9	2,511.9	+ 12.5	- 3.6
1973-74	20,055	+ 24.4	2,232.0	+ 15.5	+ 6.4
1972-73	16,121	+ 8.6	1,932.2	+ 2.0	+ 4.6
1971-72	14,841	+ 12.6	1,895.0	+ 4.2	- 1.6
1970-71	13,182	+ 10.6	1,817.9	+ 1.6	- 3.8
1969-70	11,921	+ 11.0	1,789.5	+ 1.6	- 5.5
1968-69	10,738	+ 9.6	1,760.8	+ 1.5	- 3.9
1967-68	9,798	+ 12.4	1,753.5	+ 5.8	+ 1.4
1966-67	8,718	+ 17.7	1,640.4	+ 5.9	- 2.8
1965-66	7,735	+ 7.2	1,548.4	+ 0.8	- 1.9
1964-65	7,218	+ 5.0	1,535.6	- 8.8	- 11.6
1963-64	6,872	+ 4.6	1,683.5	+ 7.2	+ 3.1
1962-63	6,570	+ 0.8	1,571.0	- 3.4	- 5.7
1961-62	6,521	+ 9.4	1,626.1	+ 7.2	+ 5.4
1960-61	5,958	+ 4.5	1,517.5	+ 0.2	- 2.7
1959-60	5,703	+ 6.3	1,514.9	+ 6.3	- 4.9
1958-59	5,364	+ 5.4	1,424.7	- 14.6	- 11.3
1957-58	5,087	+ 4.9	1,668.5	- 5.2	- 14.4
1956-57	4,849	+ 9.4	1,759.4	+ 0.5	- 6.2
1955-56	4,433	+ 3.7	1,750.1	+ 5.0	+ 10.3
1954-55	4,275	- 1.7	1,666.0	- 7.7	- 12.2
1953-54	4,351	+ 0.3	1,805.9	- 4.1	- 8.1
1952-53	4,337	+ 16.2	1,882.4	+ 33.0	+ 18.4
1951-52	3,733	+ 28.7	1,415.5	+ 81.8	n.a.
1950-51	2,901	+ 18.5	781.8	+ 103.1	n.a.

Sources: Canada, *Public Accounts*, 1950-84. Price indexes were obtained from *Canadian Statistical Review*, Statistics Canada, May 1984. The GNE index for total government spending was used for this series.

Notes: Figures from 1984-85 are official estimates; n.a. means not available.

On balance, defence expenditures have not kept pace with the overall growth in federal expenditures since the early 1950s. During the Korean War defence expenditures increased dramatically, but from 1953–54 until 1972–73 they underwent only limited growth in current-year dollars. In fact, the Department of National Defence (DND) experienced six years of negative current growth during this period. As of 1973–74 defence grew more rapidly, but at a slower rate than overall federal expenditures. Since 1980–81, however, defence resources — with the exception of 1983–84 — have grown more rapidly than federal expenditures. Yet in aggregate terms governments have placed less emphasis on the defence sector than on other areas of public expenditures. Statements by the Mulroney government indicate that the trend toward higher defence spending may continue, irrespective of the specific growth rate.

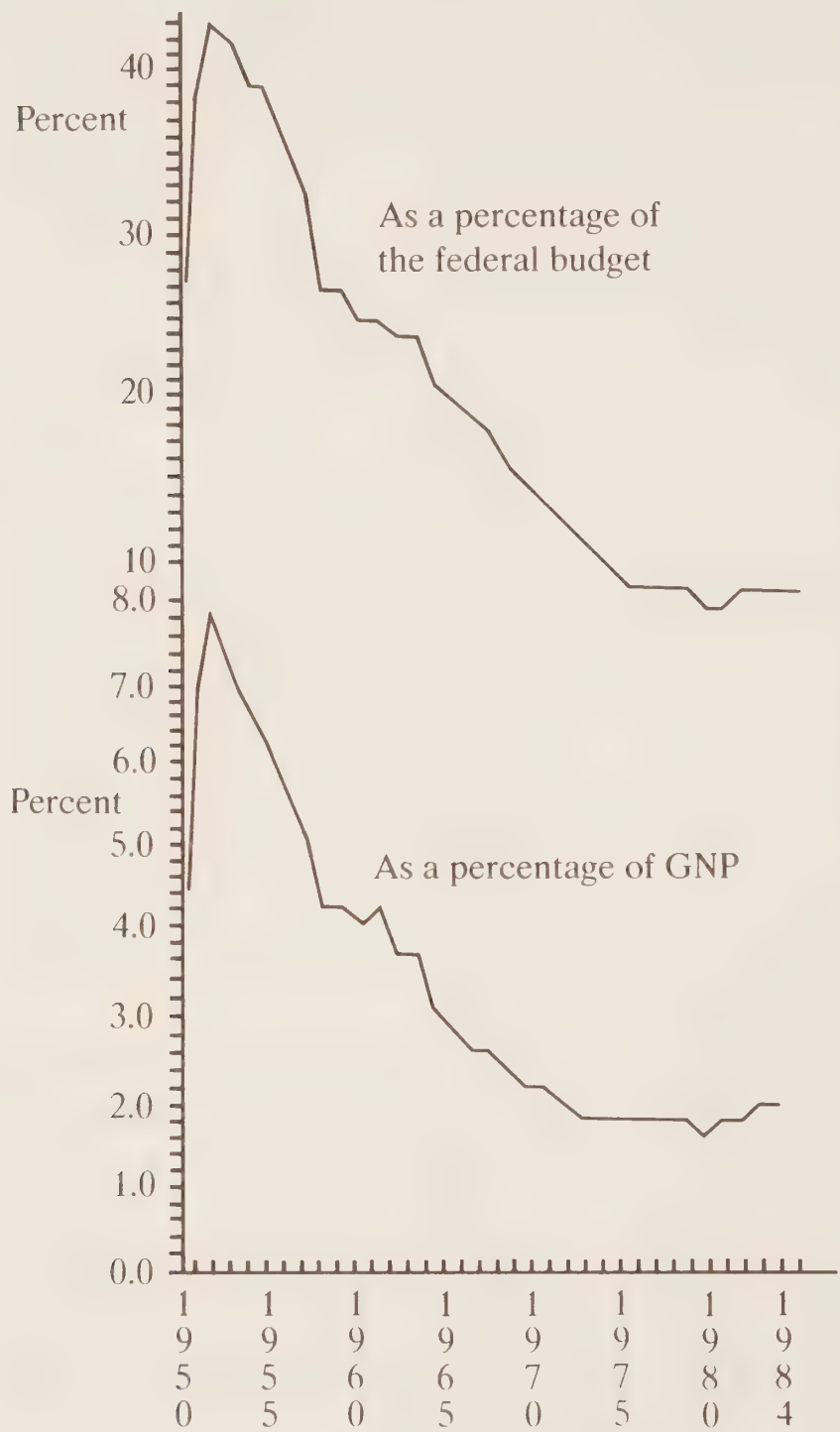
Federal and defence expenditures can also be compared from a number of other perspectives. Figure 5-1 plots defence expenditures as a percentage of the federal budget from 1950 to 1984, which gives one indication of the relative priority attached by the government to defence. From 1950 to 1974 defence expenditures — in current-year dollars — declined from just over 43 percent of federal expenditures to under 10 percent of the budget. Since the mid-1970s the defence budget, calculated as a percentage of federal expenditures, has remained relatively constant.

The same pattern exists for defence spending as a percentage of the gross national product (GNP). Defence declined from approximately 7.8 percent in the early 1950s to 1.8 percent in 1972. During the 1970s defence expenditures remained under the 2 percent figure, but since 1982 they have risen slightly to 2.1 percent of GNP.⁴⁰

The relative priority allocated to defence becomes more apparent when real growth is taken into account. Table 5-1 indicates that while real growth has generally been the norm since 1972–73, except in 1974–75 and 1979–80, DND experienced negative real growth in fifteen of the twenty years prior to 1972. Figure 5-2 outlines this pattern in terms of constant 1971 dollars. The budget declined in 1971 dollars in most years between 1952 and 1972. Since then, despite the significant increases in current dollars, the increase in constant 1971 dollars has, at best, been marginal, given inflationary and recessionary economic factors.

Since Canada is a member of NATO, it is appropriate and useful to compare the Canadian case with others within the Alliance so as to gain insights into burden sharing. However, measures of burden sharing can take a number of forms and tend to be extremely complex, given differences among NATO members. Thus burden-sharing indicators, like other defence economic indicators, can lead to different conclusions. At least five measures offer partial insights: net defence spending, defence per capita, defence as a percentage of national expenditures, military manpower as a percentage of the labour force, and defence spending as a percentage of gross domestic product (GDP).

FIGURE 5-1 Defence Expenditures as a Percentage of the Federal Budget and GNP: 1950–84



Sources: Canada, *Public Accounts*, 1950–84. Figures for 1984–85 are official estimates.

Note: Note scale differences.

FIGURE 5-2 Defence Spending in Current and Constant 1971 Dollars: 1950–83



Sources: Canada, *Public Accounts*, 1950–84. Price indices were obtained from *Canadian Statistical Review*, Statistics Canada, May 1984. The GNE index for total government spending was used for this series.

Note: Figures for 1984–85 are official estimates.

Table 5-2 compares net defence spending by NATO members for 1973 and 1983 in millions of U.S. dollars. In 1973 NATO's net defence spending was US\$121.5 billion and the United States accounted for 64.5 percent of the total, followed by West Germany, France, the United Kingdom, and Italy. Canada ranked sixth at US\$2.4 billion and 2 percent of the total. In 1983 Canada still ranked sixth at US\$6.5 billion, and 2.1 percent of the total (US\$305 billion). Given this measurement, Canada appears to be ranked appropriately within NATO. On a per capita basis (U.S. dollars) Canada also compares favourably; in 1983 Canada ranked sixth at US\$262 which indicates a substantial improvement over 1973 (US\$109) when Canada ranked ninth after Denmark.⁴¹

TABLE 5-2 NATO Comparisons of Net Spending, 1973 and 1983

Country	1973			1983		
	\$	%	Rank	\$	%	Rank
	(US\$ millions)					
United States	78,358	64.5	1	225,345	73.8	1
West Germany	11,939	9.8	2	20,580	6.7	2
France	9,494	7.8	3	19,277	6.3	3
United Kingdom	8,612	7.1	4	11,602	3.8	4
Italy	4,103	3.4	5	8,589	2.8	5
Canada	2,405	2.0	6	6,479	2.1	6
Netherlands	1,917	1.6	7	3,941	1.3	7
Belgium	1,297	1.1	8	2,433	0.8	8
Greece	675	0.6	11	1,956	0.6	9
Turkey	862	0.7	9	1,586	0.5	10
Norway	608	0.5	12	1,541	0.5	11
Denmark	582	0.5	13	1,304	0.2	12
Portugal	678	0.6	10	564	0.2	13
Luxembourg	15	0.01	14	37	0.01	14
Total	\$121,545			\$305,234		

Source: For 1973 data, see International Institute for Strategic Studies, *The Military Balance, 1983-84*. 1983 data are estimated expenditures obtained from *NATO Review* 6, 1983, p. 30.

Note: Figures were converted based on May 1, 1984 exchange rates. Trends are affected by changes in national exchange rates against the U.S. dollar.

Nevertheless, judged by other criteria Canada does not fare as well. On the basis of expenditures as a percentage of national budgets, Canada ranked ninth in 1983. In terms of military manpower as a percentage of the labour force, Canada and Luxembourg in 1983 ranked last, with 0.7 percent.

Generally, however, NATO comparisons are made in terms of defence spending as a percentage of GNP or GDP. Table 5-3 indicates that the NATO average in 1973 was 3.5 percent of GDP and varied from 6.0 percent for the United States and Portugal to 0.8 percent for Luxembourg. Canada,

at 1.9 percent, ranked second to last. In 1983 the NATO average had increased to 3.85 percent and Canada at 2.1 percent again ranked second to last. This measure, more than any other, has led to criticisms of the Canadian contribution to NATO.

TABLE 5-3 NATO Comparisons of Defence Spending as a Percentage of GDP, 1973 and 1983

Country	1973	Rank	1983	Rank
Greece	4.1	5	7.1	1
United States	6.0	2	6.9	2
United Kingdom	4.8	3	5.6	3
Turkey	4.1	4	4.9	4
France	3.8	6	4.2	5
Portugal	6.0	1	3.4	6
Belgium	2.8	10	3.4	7
Germany	3.5	7	3.4	8
Netherlands	3.2	8	3.3	9
Norway	3.1	9	3.1	10
Italy	2.7	11	2.8	11
Denmark	2.0	12	2.5 ^a	12
Canada	1.9	13	2.1	13
Luxembourg	0.8	14	1.3	14
NATO average	3.5		3.85	

Source: For 1973 data, see *NATO Facts & Figures, 1982*, p. 319. For 1983 data, see *NATO Review*, 6, 1983, p.31.
a. Estimate

Government Approaches to Defence Allocations

An overview of Canadian defence expenditures and NATO-related comparisons offers only partial insights into resource allocations. The nature of, and reasons for, government decisions with regard to defence expenditures in the post-1945 period have been diverse, dynamic and — for the most part — unresearched.⁴²

Major financial difficulties developed during the early 1960s. During this period a formula-funding approach to defence expenditures was adopted by the government, implemented by DND and, in varying forms, has been in place ever since.⁴³ The first formula consisted of limiting defence budgets to a 2 percent annual increase over five years, commencing with the 1964–65 base of \$1.5 billion. At the time it was anticipated that capital expenditures would reach 25 percent of the budget as a result of the increases and savings from unification, which would permit a five-year re-equipment program. For the most part, budgetary ceilings were maintained; but capital expenditures decreased while personnel costs continued to rise, despite a cut in personnel of 20,000. Unanticipated infla-

tion rates and cost increases for equipment rendered this formula largely ineffective.

Concern over social costs, along with the level of government spending in general, contributed to the next series of formula-funding arrangements. Between 1970–71 and 1972–73 the Trudeau administration froze defence spending at \$1.8 billion. During the freeze no direction was given regarding priority components of the defence budget or how price increases were to be taken into account. Ironically, DND was to implement the more ambitious priorities set out in *Defence in the 70s*. By this time equipment had become outdated and manpower levels continued to drop. During the freeze, ceilings were exceeded by \$200 million, while manpower levels dropped by 18,089 and capital expenditures fell to 8 percent of the total budget — an all-time low.

The next formula-funding arrangement stemmed from a modernization and renewal program, according to which the budget was to increase at 7 percent yearly for a five-year period as of 1973–74. This was the first formula arrangement to stipulate a priority emphasis for various components of the defence budget. Personnel costs were to be limited to 6 percent increases, and operations and maintenance costs to 4 percent. The majority of the increase was earmarked for capital equipment (targeted at 20 percent of the budget by the end of the five-year plan).

Unfortunately, inflation rates of only 5 percent were budgeted for equipment costs. This served to make the plan short-lived as the enormous inflationary shocks of 1974 took effect. DND required a supplementary appropriation of \$143 million in 1974–75 in order to avert a financial crisis.

Budget levels increased by 18 percent in 1975–76, but remained insufficient to meet commitments and keep pace with inflation. This led to the 1975 Phase II recommendations of the Defence Structure Review (DSR) which included a commitment to more realistic and stable funding arrangements.⁴⁴ All components of the budget were compensated for inflation, while the capital portion was to increase by an additional 12 percent. Price indexes for the various components of the defence budget are not available to the public, but the capital expenditures for the period from 1977 through to 1979 did not reach the target level of 12 percent real growth.

The DSR formula was supplemented by the government's 1978 decision to agree with NATO's proposal that defence spending target levels be set at 3 percent real growth for a five-year period through to 1983–84. In the Canadian case the formula in place at the time and the NATO 3 percent real growth formula were almost identical in terms of overall effect.

The current formula is based on the following major considerations: to continue to meet the NATO goal of 3 percent real growth; to maintain capital acquisitions at approximately 25 percent of total budget; to increase military strength to authorized levels of 82,740; to maintain current levels of operations and maintenance; and to allocate funds for readiness and sustainability.⁴⁵

The federal government currently projects spending in terms of a four-year budgetary plan, but Parliament authorizes funding on an annual basis. This reflects the adoption of a multi-year fiscal plan in line with the Policy and Expenditures Management System (PEMS) of the federal government. The expenditure plan is structured in the form of ten policy envelopes (energy, economic development, social affairs, justice and legal, fiscal arrangements, external affairs and aid, defence, parliament, services to government, and public debt). The four largest expenditure envelopes in the 1984–85 estimates (social affairs, \$39.7 billion; public debt, \$20.35 billion; economic development, \$11.25 billion; defence, \$8.76 billion) account for 81.6 percent of current government expenditures.⁴⁶

According to the expenditure plan, the defence envelope is projected to increase on average at approximately 9 percent per year: 11.2, 8.7, 8.9 and 7.4 percent through to 1987–88. Thus the Liberal government allocated a higher priority to defence than to the majority of other envelopes. The defence envelope is projected to increase to \$11,149 million by 1987–88, and defence as a percentage of federal outlays will rise from 8.9 to 9.7 percent.

Within the context of overall government expenditures, the Mulroney government is faced with major policy choices involving resource allocation. For example, in the period from 1979–80 through to 1984–85 the public debt has been the fastest-growing envelope, increasing from 16.4 to 20.7 percent of total outlays. In addition, the social affairs envelope accounts for the largest component of federal outlays (40.4 percent in 1984–85) and this will continue to be the case. Given that the public debt must be serviced and that the bulk of transfer payments are made to individuals and provinces under negotiated fiscal arrangements, the degree of budgeting flexibility available to the federal government is strictly circumscribed. This suggests continuing competition for federal dollars and the need to state government priorities explicitly.

Irrespective of overall defence allocations, the distribution of the defence budget by major component is also of central concern. For defence procurement, the percentage of the defence budget allocated for capital projects is the key issue.

The defence budget can be broken down into five major components: pay and personnel (P&P) costs for civilian and military personnel; statutory costs, including contributions to military pension funds; operations and maintenance (O&M) costs; capital costs made up of equipment, development, construction and the acquisition of land, building and other works; and grants and contribution costs made up of mutual aid and infrastructure contributions to NATO and grants to associations. For DND, budgetary restraint had a profound and adverse impact on the distribution of the defence dollar. Beginning in the early 1960s the department had to cope with an increasingly serious imbalance between the P&P and capital components of the budget.

Between 1960–61 and 1969–70 (see Table 5-4) P&P costs increased from 47.6 to 59.5 percent of the budget, while the component for equipment fell from 18.8 to 12.8 percent. (If construction is included, the capital component increases to 24.0 and 13.9 percent, respectively.) A slight reduction in O&M costs (except for increases between 1964 and 1966) partially offset increases in P&P costs, but did not have any appreciable impact on the shrinking capital component.

This adverse imbalance continued into the 1970s, as the P&P component was 56 percent (plus 12.4 percent statutory costs), which only left 18.4 percent for O&M and 12 percent for capital as of 1970–71. The low point in the capital component of the budget was reached in 1971–73 at 8 percent. Since the mid-1970s the ratio has been partially rectified as a result of government decisions to re-equip the Canadian Forces. As of fiscal year 1985–86 the ratio should reflect an appropriate balance with P&P at 38.1 percent (46.0 percent when the statutory component is included), O&M at 24.6 percent and the capital component at 27.2 percent.⁴⁷

Regardless of defence commitments, it is essential that there be a reasonable ratio among the major components of the budget, for the imbalances of the 1960s and early 1970s caused serious internal difficulties within DND, and these have been difficult to rectify.

Future Defence Funding Options

Given greater interest in defence as public policy the government may wish to consider various alternatives for the allocation of resources to defence. Formula funding is too easily modified on grounds of political or economic expediency. Long-range planning, especially for capital procurement, has been lacking and commitment-capabilities relationships can be ignored. In addition, there has been a tendency to develop defence requirements in terms of formula funding requirements rather than clearly articulated defence objectives and requirements.

The most frequently mentioned options tend to be variations of formula funding. For example, one option would be to link defence spending explicitly to future NATO growth targets. This would provide for a secure defence resource base, but a loss of political independence could arise because Canada would have less control over its defence budget. In addition, NATO is not synonymous with the full range of Canadian security interests and requirements. Nevertheless, NATO considerations should be taken into account in assessing Canada's contribution to the Western Alliance.

Another variation would be to adopt the NATO GDP average or else target a percentage of the Canadian GNP for defence. The NATO GDP average has limitations similar to the first option. In addition, this approach would mean that the Canadian defence budget would become dependent on the budgetary fluctuations that govern other NATO members.

TABLE 5-4 Distribution of the Defence Budget by Major Subaggregates, 1960-61 to 1985-86

Fiscal Year	Pay and Personnel	Statutory ^a	Operations and Maintenance	Capital	Grants and Contributions
(percent)					
1985-86 ^b	38.1	7.9	24.6	27.2	1.5
1984-85 ^b	38.7	7.8	25.5	26.9	1.6
1983-84	40.7	7.6	26.5	23.2	2.1
1982-83	43.2	8.0	24.7	21.9	2.2
1981-82	44.0	8.6	24.6	19.9	2.8
1980-81	45.3	7.8	24.2	19.3	3.5
1979-80	48.1	7.7	22.6	19.4	2.2
1978-79	49.0	8.7	23.9	17.0	1.5
1977-78	49.4	12.0	22.8	15.0	0.9
1976-77	52.7	12.5	19.8	14.2	0.8
1975-76	53.9	13.9	19.3	12.0	1.0
1974-75	56.8	14.0	17.3	10.7	1.2
1973-74	56.8	12.9	18.6	10.2	1.4
1972-73	62.0	11.3	17.6	8.0	0.9
1971-72	60.0	10.0	17.6	11.1	1.9
1970-71	56.0	12.4	18.4	12.0	1.2
1969-70	59.5	—	22.6	13.9	1.3
1968-69	59.0	—	23.6	15.4	1.5
1967-68	56.8	—	24.4	16.3	1.5
1966-67	56.4	—	26.0	15.6	1.4
1965-66	51.5	—	34.5	14.7	1.2
1964-65	53.0	—	35.1	16.3	2.0
1963-64	53.7	—	26.2	17.3	2.0
1962-63	51.0	—	26.2	20.3	1.8
1961-62	47.8	—	23.4	24.2	1.1
1960-61	47.6	—	26.6	24.0	1.3

Source: Public Accounts, Canada, 1960-61 to 1983-84.

a. Statutory costs for pre-1970-71 have not been clearly separated from the major subaggregates due to changes in departmental accounting procedures; thus some of the components may seem inflated when compared with post-1970-71 totals. Expenditures classified as "other" have not been included in pre-1970-71 data; these range from 0.3 to 2.6 percent of total budget.

b. Projected estimate; allotments for readiness and sustainability not included.

On the surface, it is appealing to peg defence spending to the performance of the Canadian economy. It is easy to understand and, if set high enough, would allow for increases in the defence budget to help overcome the commitment-capability gap. Furthermore, such an approach, if adhered to on a continuing basis, would ensure a consistent allocation of defence resources.

Nevertheless, this entails a number of serious drawbacks. This approach would require that the defence budget be determined exclusively by fluctuations in the Canadian economy. More seriously, the GNP figure could be set too low to meet Canadian defence requirements. Third, and most important, there is no direct relationship between Canadian defence requirements and GNP formula funding.

Given the difficulties that Canadian governments have had in establishing a clear relationship between commitments and capabilities, it may be that all formula funding approaches should be abandoned.

The cabinet could base the defence budget on a commitment-capability funding model.⁴⁸ Defence resource allocations could proceed from the following set of considerations: first, that defence objectives and defence commitments should be identified and articulated in specific terms; second, that force structure needs should be clearly identified in terms of declared commitments; third, that equipment requirements should be established in relation to commitments; fourth, that personnel and infrastructure requirements should be identified; and, fifth, that funding allocations should be based on a detailed assessment of the above factors and authorized on a multi-year basis.

If the cabinet deems defence expenditure levels excessive on either political or economic grounds, then the government can modify its commitments. It is essential, however, that commitments and capabilities be kept in balance and that funding for defence be maintained on a consistent, coherent and long-term basis.

Defence Procurement: Objectives and Outcomes

In order to appreciate the complexities of Canadian defence procurement it is necessary to analyze the relationships that exist between procurement policy and procurement strategy, taking into account various structures and processes. In this chapter the procurement options open to the Canadian government are discussed, and a historical overview of procurement outcomes is provided. This approach allows for the Defence Department's 15-year capital acquisition program to be placed within a policy context.

Options for Defence Procurement

Canadian governments, like all governments that maintain modern armed forces, have had to address the issue of providing the necessary equipment and infrastructure for the operations and maintenance of military forces. Given the cost, complexity and technological requirements of major weapons systems (ships, aircraft, tanks, etc.), the weapons acquisition process for most countries has become more lengthy, complicated and costly.

The range of procurement modes available to government varies considerably, but four basic modes can be identified: indigenous national procurement, licensed production, offshore purchases, and joint ventures. The utilization of a particular procurement mode depends upon such factors as the government's procurement policy and strategy, including cost factors; the research and development (R&D) capability of the industrial defence sector; the production capability of the industrial defence sector; and the actual products, including their export potential.

With few notable exceptions, all states must rely on some mix of these four methods to equip their armed forces. As military equipment has become more costly and technologically advanced, the ability of states to rely solely on indigenous national procurement has declined. Even traditional major arms producers, such as the United Kingdom and France, are no longer able to maintain the necessary industrial infrastructure to meet all their military procurement requirements. The requirements imposed on government and industry for each type of the four procurement modes are outlined in Table 5-5.

**TABLE 5-5 Defence Procurement Modes:
Requirements of Government and Industry**

Procurement Mode	R&D Capability	Production Capability	Export Potential	Government Support	Government Policy
Indigenous	essential/ complete	essential/ complete	generally essential	important/ consistent	essential/ consistent
Offshore	not required	not required	not applicable	not applicable	as required
Licensed production	not required	essential/ complete	could be important	not applicable	as required
Joint venture	essential/ partial	not necessarily required	varies	important/ as required	essential/ consistent

In the case of indigenous procurement, there must be close cooperation and coordination between government and industry. A clearly articulated, consistent and long-term government procurement policy and strategy are prerequisites, and in many cases government financial support is required. On the industrial side research, development, testing and production capabilities are necessary. Furthermore, indigenous production generally demands a long production run and an export market to enhance cost-effectiveness, although this is not the case for some systems, such as large naval vessels, nuclear missiles and the like. An indigenous procurement mode is the most difficult and complex to sustain.

The least complex mode is to purchase equipment offshore, when it is available. A domestic defence industry for the importing country is unnecessary, and the government's procurement policy can vary to meet specific military needs. Offshore purchases, however, mean reliance on foreign suppliers and the compatibility of foreign equipment with national defence requirements. In addition, this procurement mode has no impact on the importer's domestic and industrial base and has a negative effect on the balance of trade; it also drains foreign currency reserves.

In order to offset some of the negative economic implications of offshore procurement, the parties involved can cooperate in joint ventures and/or negotiate for licensed production. Joint ventures, such as the British-French Tornado interceptor or the proposed standardized NATO frigate, demand a high degree of international cooperation and require the harmonization of procurement policies and strategies of the nations involved. They also require agreement on equipment standardization, and on distribution of the market. Despite NATO's continuing emphasis on increased standardization, the joint venture approach to procurement has not been a norm, given the political and economic difficulties involved, although it is one mechanism that can help to ensure the continuation of industrial R&D and production capabilities for the equipment under joint development.

Procurement by licensed production requires a domestic production capability, but no R&D capability. It may or may not involve export potential, depending upon the arrangements with the foreign prime contractor. There are a number of benefits to industry, for a national production capability is acquired along with partial technology transfer. Government procurement policy and strategy can vary as required even though the labour force and industrial infrastructure must be developed or be in place.

There can, of course, be variations on the four basic procurement modes. A partially indigenous mode has often been utilized where partial R&D and production capabilities are retained in a specific area. The Canadian shipbuilding industry is a case in point. Offshore procurement can be modified to meet national requirements, as in the case of the CP-140 Aurora maritime patrol aircraft. Similarly, there can be modified licensed production, as was the case with the F-86 Sabre fighter aircraft.

The procurement mode pursued by government is not synonymous with the industrial defence base, for products can be developed and produced exclusively for the export market. Nevertheless, the industrial defence sector circumscribes the procurement mode. Without full capabilities for R&D, testing, and production, an indigenous procurement mode is not an option.

*A Historical Overview*⁴⁹

In the Canadian case the prerequisites for an indigenous industrial defence base do not exist. Canada has relied primarily on offshore purchases. Since 1945 approximately half of the major acquisitions have been made offshore;

these include main battle tanks; most weapons systems; army helicopters, the F-101 Voodoo, the CF-18, transport aircraft, and maritime aircraft including helicopters; aircraft carriers, submarines, and so on.

To a lesser degree, licensed production has been utilized to equip the Canadian Forces. No major naval acquisitions fall into this category, but licensed production was resorted to for the F-86 Sabre, the CF-104, and the CF-5 aircraft. No military aircraft has been produced under licence in the past 15 years. In the current re-equipment program, licensed production has been employed to acquire the armoured vehicle, general purpose (AVGP), 2½-ton military trucks and the Colt M-16 rifle for the land forces. Unfortunately, the current products under licence do not involve high-technology equipment and thus technology transfers are limited. Furthermore, unless export markets develop, production lines will close and no continuing benefits will accrue to the Canadian economy.

Indigenous procurement has not been an option for equipping the Canadian Forces even though approximately one-quarter of major equipment acquisitions have been of this type since 1945. In the case of land equipment, the only attempt to develop a Canadian capability was that involving the Bobcat amphibious armoured personnel carrier. By way of contrast, there was a concerted effort to develop and sustain a Canadian capability to produce high-performance military aircraft.

The first all-weather jet interceptor for the RCAF, the CF-100, went through the entire production cycle within Canada. This led to R&D, commencing in 1953, by A.V. Roe on a subsequent aircraft, the CF-105 Avro Arrow. The history of the Avro Arrow has been well documented and its demise has assumed a significant place in Canadian aerospace history.⁵⁰ Cost overruns, numerous design modifications, changes in the strategic environment, the lack of export potential and, most important, government indecision and lack of foresight were factors that led to cancellation of the project by the Diefenbaker government in 1959. This resulted in the decimation of highly developed R&D teams and the loss of highly skilled members of the work force to the United States. The Avro decision implied the end of an indigenous military-aircraft industry in Canada.

As a partial substitute, the Conservative government negotiated the Defence Production Sharing Agreement (DPSA) with the United States and opted for offshore purchase of the F-101 and the Bomarc missile to meet Canadian air defence requirements.

The indigenous procurement of naval ships has fared somewhat better than that of military aircraft. From the mid- to late 1950s, seven St. Laurent-class and seven Restigouche-class destroyer-escorts were commissioned followed, in the early 1960s, by four Mackenzie-class destroyer-escorts and two Annapolis-class destroyers. Subsequent naval programs retained the partially indigenous naval procurement option in the form of four Tribal-class helicopter-equipped destroyers commissioned in 1972 and

1973. The six frigates that make up the Canadian Patrol Frigate (CPF) program fall into this category.⁵¹

The historical examples indicate that problems relating to indigenous procurement modes in Canada can be linked to government procurement policy and strategy.

Policy, Strategy and Process

The interrelationships among policy, strategy and process are complex, yet the major criteria for each can be identified.

Procurement policy should stem from the following requirements: a statement of the defence objectives in terms of commitments, activities, and the roles and missions of the armed forces; guidelines regarding the type of military infrastructure and equipment required; resource allocation requirements for the overall capital component of the defence budget and/or for specific acquisitions; and guidelines for procurement time cycles.

Procurement strategy, which should flow from policy, requires: guidelines for the procurement mode to be pursued; objectives regarding the indigenous industrial defence sector of the economy, including defence enhancement programs for industry, R&D requirements and long-term defence industrial needs; and procedures for defence suppliers.

Procurement process, in order to be standardized, requires identification of the phases, decision points and procedures to be followed, including: the government's mechanisms for the monitoring and control of the procurement cycle; DND structures and procedures for equipment acquisitions; and the involvement of the other government departments and agencies as required.

Procurement policy is the responsibility of the government of the day and thus is political in nature. With adequate political interest and leadership in defence, a clearly articulated, consistent and long-term procurement policy can be adopted. No such policy, based upon the criteria outlined above, currently exists in Canada. The major reasons are political and economic in order of importance, i.e., the lack of political will, interest and leadership of the part of successive Canadian governments since the late 1950s, and second, the lack of sufficient defence resources to formulate a long-term procurement strategy.

In the immediate post-World War II era no procurement policy was deemed necessary, because demobilization was the order of the day. Nevertheless, with the Korean War the Canadian forces were expanded in size and re-equipped on a crash basis. For the most part this equipment base carried over into the early 1960s, with several notable exceptions. The Liberal government of the mid-1950s approved R&D for the Avro Arrow and proceeded with naval programs. These programs did not

constitute a clearly stated procurement policy, but rather flowed from individual service requests and requirements.

Procurement policy was in part a factor in the disastrous handling of defence matters by the Diefenbaker government. The inability to appreciate that nuclear weapons platforms required nuclear systems (Bomarc, Honest John, etc.), coupled with the cancellation of the Arrow and the acquisition of American aircraft and missiles, indicated uncertainty and confusion on the part of the government.⁵²

During the Pearson and early Trudeau years, the mistakes of the Diefenbaker era were avoided, but no long-term procurement policy emerged. The 1964 defence white paper made a partial attempt to establish equipment acquisition priorities, but with limited resources procurement was minimal, as in the case of the navy, or inappropriate to declared objectives and commitments, as in the case of the CF-5. With the defence freeze of the early Trudeau years no major procurements were considered, and the 1971 white paper did not attempt to spell out equipment requirements.

Since 1976, the government has had a three-part procurement policy that originated with the 1975 Defence Structure Review (DSR). The DSR remains classified and the extent of the guidance it provides to DND remains somewhat obscure, even though the fifteen-year re-equipment program indicates the range of requirements. The second element is the government's adherence to NATO's 3 percent real growth guidelines. The third element is the stated objective of the Defence Services Program to allocate at least 25 percent of the budget to capital equipment.

The underlying problems, however, remain unresolved. First, the government has not linked these three elements to a clearly stated procurement strategy. Second, there has been no firm long-term commitment to continued real growth in defence spending. Finally, the Liberal government appeared to deal with procurement on an ad hoc basis. The Trudeau administration was aware of the problems and in the fall of 1981 established a Defence Procurement Review (DPR). The terms of reference were broad in scope, but the 1982 report (which is classified) did not recommend an explicit defence procurement strategy for Canada. DND has a Procurement Policy Directive, but the government has no defence procurement strategy.

To avoid confusion and misunderstanding it should be noted that the government has a general procurement strategy as outlined in the 1980 Procurement Review Mechanism (PRM)⁵³; but this makes no reference to defence procurement. The Canadian government also has a number of defence industrial enhancement programs and has structured the current re-equipment program around industrial benefits, but this does not in itself constitute a procurement strategy.

It should also be noted that a procurement strategy is not necessary for the acquisition of equipment. Defence procurement can proceed, and for Canada generally has, in the absence of an overall strategy. The policy

that has been pursued can be categorized as an ad hoc undirected strategy. The procurement needs of the Canadian Forces indicate that a more rigorously directed procurement strategy seems desirable.

The lack of a procurement strategy is surprising given that: a procurement policy, of sorts, appears to exist within DND; the government and DND have established a military procurement process; the government has a number of defence industrial enhancement programs; DND accounts for 49 percent of the \$4.7 billion the federal government currently allocates to capital expenditures; the Canadian Forces have been in the process of a major re-equipment program since the mid-1970s; currently authorized defence capital requirements are approximately \$16 billion; and, projected defence capital requirements through to the year 2000 are reportedly \$55 billion.

Nevertheless, it is important to draw a clear distinction between the government's approach to procurement and its approach to the industrial sector, which produces defence products. A procurement strategy need not be related to the development of an indigenous defence procurement sector. All countries, Canada included, have linkages between defence procurement and their defence industries. The key issue is the extent to which these are harmonized as part of an overall strategy.

Since Canada lacks an industrial strategy for the economic development of the country, it should come as no surprise that Canadian defence procurement and Canadian defence industries are not explicitly and systematically linked. This does not mean that Canadian governments have been completely unresponsive to the needs of Canadian industries in the defence sector; but rather that, in the absence of a coherent procurement strategy, defence industries, like defence as public policy, have been subjected to inadequate and inconsistent government attention and support.

DND's Capital Acquisition Program

Canada's current re-equipment program⁵⁴ for the Canadian Forces dates primarily, but not exclusively, from Phase II of the DSR. Prior to the completion of the review, the government had approved in principle the acquisition of a long-range maritime patrol aircraft. Stemming more directly from the review, the government approved the purchase of 128 C-1 Leopard main battle tanks, the general-purpose armoured vehicle, the military truck program, the new fighter aircraft program and the first phase of the Canadian patrol frigate program. Within the last year, the government has approved the acquisition of new small arms, new jeeps and five-ton trucks, additional self-propelled artillery, and is in the process of opening contract bids for low-level air defence systems.

According to the 1984-85 estimates, the capital component of the current defence services program has overall capital expenditures that approach \$22 billion. More than 95 percent of this amount has been allocated to

equipment purchases. According to the estimates, expenditures to April 1984 amounted to \$6 billion while expenditures for 1984–85 are estimated to be \$2.3 billion. This leaves \$13.7 billion for future requirements.

Table 5-6 lists 63 DND major equipment programs that have been approved by the government. The total estimated costs of these programs amount to \$14.3 billion, of which 43.1 percent has been allocated for aircraft and engines, 39.9 percent for ships, 7.4 percent for military vehicles, 4.1 percent for electronics and communications, 4.3 percent for ammunition and bombs, 0.9 percent for development and the remainder for training and miscellaneous equipment.

In the current equipment program, the Canadian patrol frigate constitutes the major expenditure at 38.6 percent of the total. This is followed by the new fighter aircraft at 34.5 percent and the long-range patrol aircraft program at 8.2 percent (the latter is virtually complete). These three programs account for some 80 percent of equipment requirements that are currently funded, and indicate the extent to which several major and expensive projects can consume the majority of the capital budget over extended periods of time.

Despite the substantial improvement in the capital component of the defence budget since the mid-1970s and despite the range of projects under way, the Canadian Forces still remain in a situation where existing programs are not sufficient to meet current commitments.

The House of Commons Standing Committee on External Affairs and National Defence has identified some 24 projects considered essential for DND in terms of future equipment requirements (see Table 5-7). This list reflects the DND view that approximately \$55 billion in 1983 dollars will be required by the year 2000 for some 315 defence equipment projects. These funds are deemed to be the minimum required to update current capabilities. According to reports, however, the Liberal government had approved only \$28 billion in capital funding, i.e., approximately 51 percent of the amount requested, prior to its defeat in the 1984 general election.

Projected Canadian capital requirements may be higher than estimated. The American case⁵⁵ suggests that equipment programs have often been underestimated, and if DND estimates have relied on American data, then actual costs could escalate. The current cost projection of the CF-18 program would be a good example. Irrespective of cost projection assumptions, the overall funding problem is accentuated by the ever-increasing cost of military equipment and the infrastructure required to ensure operational effectiveness. The financial requirements for the range of equipment outlined in Table 5-7 may prove too costly for the Canadian government, given competing demands for limited federal resources and current government restraint.⁵⁶

At a minimum the magnitude of the gap between requested allocations and currently funded programs indicates the policy choices available. If the government retains its stated priority for defence then resources must

**TABLE 5-6 Current Major Equipment Program,
Department of National Defence**

Equipment	Estimated Total Cost (\$ millions)	Percent
Ships		
Canadian patrol frigate	5,516.0	38.6
Destroyer life extension	133.9	0.9
Submarine update	42.4	0.3
Subtotal	5,692.3	39.9
Aircraft and engines		
New fighter aircraft	4,927.7	34.5
Long-range patrol aircraft	1,168.3	8.2
Helicopter upgrade (SARUP)	36.9	0.3
Helicopter update (VOFUP)	20.8	0.1
Subtotal	6,153.7	43.1
Military vehicles		
Medium logistic vehicle	315.8	2.2
Armoured vehicle general purpose	302.4	2.1
Tank replacement	255.7	1.7
Military support trucks	118.3	0.8
Trucks, cargo	67.3	0.5
Subtotal	1,059.5	7.4
Electronics and communications		
Regional operation control centres	90.8	0.6
Terminal radar control system	83.6	0.6
Sonobuoy replacements	57.3	0.4
Communications improvement	52.7	0.4
Data link plotting	49.7	0.3
Aeronautical communications systems	35.3	0.2
Air combat manoeuvring range	32.7	0.2
Search and rescue satellite	26.1	0.2
Other electronic (15 projects less than \$25 million each)	153.3	1.1
Subtotal	581.5	4.1
Ammunition and bombs		
Land	453.1	3.2
Air	60.1	0.4
Sea	53.1	0.4
155 mm howitzer	26.7	0.4
Air-ground weapons	14.7	0.1
Subtotal	607.7	4.3

**TABLE 5-6 (cont'd) Current Major Equipment Program,
Department of National Defence**

Equipment	Estimated Total Cost (\$ millions)	Percent
Training equipment		
CT-130 flight trainer	18.6	0.1
Other (2 projects)	5.0	0.04
Subtotal	23.64	0.14
Miscellaneous equipment		
Chemical weapon clothing	22.0	0.2
Webbing	17.6	0.1
Subtotal	39.6	0.3
Development		
Towed array sonar	30.6	0.2
Infrared search and target system	18.0	0.1
SAR satellite system	12.7	0.1
Synthetic aperture radar	11.5	0.1
Sonar data system	13.5	0.1
Signal processor	10.6	0.1
Other (7 projects)	27.6	0.2
Subtotal	124.5	0.9
Total	14,282.4	100.0 ^b

Source: Department of National Defence, 1984-85. *Estimates, Part III, Expenditure Plan*, 1984.
a. The programs listed are those in excess of \$1 million that have received funding approval.
b. May not total 100.0 due to rounding.

be increased. Even so, it may still be necessary to reduce commitments in order to bridge the commitment-capability gap. Regardless of Conservative resource allocation decisions, the opportunity exists for Canadian-based defence industries to participate in meeting the equipment requirements of the Canadian Forces to a greater extent than in the past.

The Defence Industries

Canada's defence-related industries constitute a sector of the national economy which is under-analyzed, yet controversial.⁵⁷ This section offers an overview of the defence sector within the context of the national economy with specific reference to the state of the defence market. The aerospace and shipbuilding sectors will then be discussed, because of their importance as high-technology industries and their potential for supporting the development of the Canadian industrial defence base.

**TABLE 5-7 Major Current Unapproved Projects
DND's Current 15-Year Program**

Projects under Consideration

1. Plan 2000 — strategic communications system
 2. Ship replacement — Phases II and III
 3. DDH-280 update (now includes ASSM) — TRUMP
 4. UHF secure voice system
 5. Military operational and support trucks (MOST)
 6. CF-18 attrition procurement
 7. Search and rescue helicopter replacement
 8. Medium tactical utility transport
 9. Submarine replacement project
 10. Future family of close support artillery weapons
 11. C-135 mid-life update
 12. C-136 mid-life modernization
 13. NORAD modernization (formerly surveillance radar replacement)
 14. Air-to-air missiles
 15. Aurora update
 16. Advanced air-to-surface weapons
 17. Tactical command, control and communications systems
 18. Training aircraft replacement
 19. Torpedoes
 20. Sea King replacement
 21. Auxiliary vessel replacement
 22. Land combat vehicles
 23. Heavy transport aircraft replacement
 24. Operational support ship replacement
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Source: House of Commons, Standing Committee on External Affairs and National Defence, *Minutes of Proceedings and Evidence*, May 12, 1983, A1-A3.

Note: The original list included 26 projects. The small arms replacement program and the low-level air defence project were subsequently approved by government, as was part of MOST, which is included in the table.

An Overview of the Defence Sector

In order to place the defence sector in a broader economic context, it is necessary to provide a brief overview of the national economy.⁵⁸ In 1983 Canada's gross national product (GNP) at market prices was \$389 billion (\$134 billion in constant 1971 dollars), while the gross domestic product (GDP) at product factor cost was \$359 billion (\$119 billion in constant 1971 dollars). The manufacturing sector, which includes most defence industries, accounted for 17.5 percent of the GDP in 1982. Foreign trade exports of merchandise in 1983 amounted to \$90.9 billion. The manufacturing sector accounted for 52.4 percent of commodity exports, including 23.5 percent in motor vehicles and parts. Canadian exports to the United States accounted for 74 percent of commodity exports.

Merchandise imports in 1982 stood at \$75.8 billion. Producers' equipment accounted for 20.3 percent and industrial material for 21.8 percent of commodity imports. Producers' equipment and industrial material would include

the majority of defence-related imports for the Canadian Forces. The United States accounted for 71.6 percent of commodity imports.

In 1983, 12.2 million Canadians were in the labour force, but only 10.7 million were employed. In 1982 the manufacturing sector employed 1.7 million Canadians (14.3 percent of the labour force), the construction sector 413,000 (3.5 percent of the labour force), and the transportation, storage and communications sector employed 828,000 (7.0 percent of the labour force). These three sectors would include the majority of those employed in defence-related industries.

Neither DND nor the Department of Supply and Services maintain readily available data on the domestic defence market. Outside of government, the data are collected primarily by the Aerospace Industries Association of Canada (AIAC) and the Canadian Shipbuilding and Ship Repair Association (CSSRA). Despite the fact that Canada has a significant defence market in electrical and electronic components, the Electrical and Electronics Manufacturers' Association does not have a data base relating to the defence industries in their sphere of activity.

Despite the lack of data, however, it is clear that Canada's defence-related industries do not make a major contribution to the national economy. In 1983, defence activities in Canada (the defence budget plus defence exports) accounted for 2.4 percent of GNP. In terms of reported exports plus estimates of domestic defence sales, the industrial defence sector accounted for 0.5 percent of GNP. Defence-related exports represented 1.6 percent of total exports and 2.0 percent of imports in 1982. Furthermore, the percentage of the labour force employed in defence industries is relatively insignificant compared with the overall work force of the country.

Perspectives on the defence industries can be ascertained from the data contained in Table 5-8. The data indicate that, of the top 500 companies in Canada as ranked by volume of sales in 1983, only eight defence sector companies are listed, and these accounted for total sales of \$2.3 billion, of which less than half was defence-related. The top-ranked company is Pratt & Whitney (ranked 141) with sales of \$504 million, followed by Bombardier (ranked 146) with sales of \$491 million. The other leading companies, Canadair, Canadian Marconi, Spar Aerospace, Litton Systems, McDonnell Douglas, and De Havilland had sales of \$387 million, \$249 million, \$215 million, \$186 million, \$159 million, and \$122 million, respectively, for 1983. Thus none of the major companies dealing with defence-related projects are among the top 100 Canadian companies, and five of the eight rank in the range from \$250 million to \$500 million in sales.

In addition to the *Financial Post* 500 there are a number of other major Canadian companies with sales exceeding \$100 million dollars. Some of these companies, CAE Electronics, Davie Shipbuilding, General Motors Diesel Division, and Manutronics have been included in Table 5-8. Others could have been included. The data suggest that only a small number of

TABLE 5-8 Major Companies with Defence-Related Sales, 1983

Company	Top 500 Rank	Sales \$ Millions	Percent Exported	Percent military Related	Number of Employees	Ownership
Pratt & Whitney	141	504	70	8	6,800	United States
Bombardier	146	491	n.a.	n.a.	4,600	Canadian
Canadair	178	387	80	20	4,300	Federal Government
Canadian Marconi	262	249	75	75	3,049	United Kingdom
Spar Aerospace	287	215	60	20	2,041	Canadian
Litton Systems	316	186	83	50	2,444	United States
McDonnell Douglas	355	159	99.6	19	2,800	United States
DeHavilland	422	122	85	45	3,000	Federal Government
CAE Electronics	n.r.	150	70	50	1,500	Canadian
Davie Ship-building	n.r.	150	n.a.	10	2,000	Canadian
G.M. Diesel Division	n.r.	150+	n.a.	n.a.	2,000	United States
Manutronics	n.r.	120	5	5	1,100	Canadian/ United States

Sources: The Financial Post 500, summer 1984. Military Technology 8 : 1 (Special Supplement), 1984.

n.r. Not ranked in top 500 Canadian-based companies.

n.a. Data not available.

companies have defence-related sales that exceed \$100 million per year.

The labour force of the 12 companies listed in the table is approximately 35,000, but based upon percentage of military sales it is estimated that only one-half of this figure can be attributed to the defence sector. It should be emphasized that these companies employ highly skilled workers in leading technologies such as avionics, electronics and communications.

The ownership pattern for the leading companies prevails for the defence industries as a whole, i.e., approximately 50 percent are foreign-owned. Of the companies listed in Table 5-8, four are American-owned, one is British-owned, four are Canadian-owned, and two are owned by the federal government. Canadair and De Havilland have only been kept in operation by substantial government subsidies in the range of several billion dollars.

Unofficially, the Canadian government encourages defence-related firms to diversify to the maximum in order to avoid placing undue emphasis on military-related products. The table indicates that in the majority of cases the percentage of defence sales is less than 50 percent, with the exception of McDonnell Douglas and Canadian Marconi.

While no quantitative data are available for other Canadian defence-related companies, fragmentary information suggests that the smaller companies tend to be more reliant on the sale of military products than are the larger companies. For example, companies such as Aviation Electric, Aircraft Appliances, Cercast, Atlantis Flight Research, Computing Devices, Leigh Instruments, Hermes Electronics, Scintrex, Targa Electronics and SR Telecom are all more than 50 percent reliant on the defence sector. In every instance these companies have sales of less than \$100 million per year.⁵⁹

The Defence Market: Domestic and Foreign

Comprehensive and time series data on Canadian defence production are not available from any single source. Based on partial statistical information, it is clear that Canadian defence industries are primarily export-oriented. No significant domestic defence market has developed because of the lack of sustained DND procurement during the late 1960s and early 1970s. Also, government policy has not emphasized Canadian content. Consequently the Canadian market for domestic defence products has not grown at the same rate as the capital component of the defence budget.

According to Table 5-9, total defence trade for the 1959-83 period totalled more than \$22.1 billion, with a trade surplus of \$1.2 billion in Canada's favour. The surplus was built up prior to 1980, and since 1981 there has been a negative balance of \$153.1 million (\$94.3 million in 1982 and \$58.8 million in 1983). The overall favourable balance of trade is largely a function of Canada's overseas surplus, given the negative balance with the United States (see Table 5-15). The current trend will continue unless the Canadian government takes steps to rectify the situation.

Canada's defence trade is primarily with the United States, as 90.7 percent of imports and 70.9 percent of exports are cross-border transactions. This trend has been relatively constant over time, even though Canada imported slightly less from the United States during the 1960s and 1970s. In terms of exports the market distribution is more geographically diversified, as 29.1 percent of exports have been to overseas markets. Some 11 percent

TABLE 5-9 Defence Trade Statistics, 1959-83

	1959-80		1981		1982		1983		Total 1959-83	
	\$	%	\$	%	\$	%	\$	%	\$	%
(Cdn\$ millions)										
Export										
United States	5,195.5	68.6	826.6	71.8	1,027.9	71.7	1,227.4	81.5	8,257.4	70.9
Overseas	2,378.3 ^a	31.4	324.2	28.2	406.2	28.3	273.8	18.5	3,382.5	29.1
Total	7,473.8	100.0	1,150.8	100.0	1,434.1	100.0	1,481.2	100.0	11,639.9	100.0
Imports										
United States	5,534.9	87.7	1,033.8	95.3	1,462.4	95.7	1,458.8	94.7	9,489.9	90.7
Overseas	778.8 ^a	12.3	50.9	4.7	66.0	4.3	81.2	5.3	976.9	9.3
Total	6,313.7	100.0	1,084.7	100.0	1,528.4	100.0	1,540.0	100.0	10,466.8	100.0

Source: Defence Programs Branch, Department of External Affairs.

a. Not available 1959-61.

of defence exports in 1982 went to the Western European market, and other overseas markets accounted for 18 percent. In terms of the world defence export market the Canadian share is approximately 3 percent.⁶⁰

Canadian defence industries have specialized by sector. In descending order of importance (ranked by volume of sales) as of 1983 these were aerospace, electrical and electronics, vehicles, shipbuilding, armaments, and general purchasing (see Table 5-10).

**TABLE 5-10 Canadian Defence Exports to the United States
by Industry Sector, 1959-83**

Industry Sector	1959-80	1981	1982	1983 ^a	Total 1959-83
(Cdn\$ millions)					
Aerospace	2,273.3	335.4	260.3	389.2	3,258.2
Armament	465.2	16.9	34.4	33.4	549.9
Electrical and electronics	1,691.1	252.1	412.0	343.0	2,698.2
General purchasing	103.3	23.2	41.2	16.5	184.2
Shipbuilding	350.2	132.9	123.9	103.7	710.7
Vehicles	312.4	66.1	156.1	252.3	786.9
Total	5,195.5	826.6	1,027.9	1,138.1	8,188.1

Source: Defence Programs Branch, Department of External Affairs
a. Estimated.

Table 5-11 illustrates the changes that have occurred within the Canadian aerospace industry in the period from 1963 to 1984. In 1963 total industry sales were \$550 million, of which the military sales component accounted for 66 percent and exports for the total industry sector (civilian and military) accounted for 40.5 percent. By 1983 industry-wide sales amounted to \$3.2 billion, with the military component of the sales accounting for 21.4 percent (1981) and total exports (civilian and military) 80.0 percent. The 20-year trend is clear: an increased export market with a smaller military component. This also appears to be the case with other sectors of the defence industry, except shipbuilding, even though data are not readily available.

Canadian defence exports to the United States by industry sector for the period from 1959 through to the end of 1983 are listed in Table 5-10 above. During this period some \$8.2 billion worth of military products were exported to the United States, the aerospace sector accounting for

TABLE 5-11 Canadian Aerospace Industry Statistics (Avionics Included), 1963-84

Year	Total sales (\$ millions)	Military Sales (\$ millions)	Military as Percent of Total	Exports (\$ millions)	Exports as Percent of Total	New capital Expenditures (\$ millions)	Employees (000)
1963	550	363	66.0	223	40.5	n.a.	n.a.
1964	589	365	67.5	284	48.2	18.0	37.5
1965	541	335	61.9	251	46.4	22.0	37.9
1966	594	297	50.0	300	50.5	26.7	45.9
1967	680	367	54.0	402	59.1	26.7	48.1
1968	750	412	54.9	559	74.5	39.0	47.8
1969	695	366	52.7	497	71.5	29.6	44.9
1970	659	344	52.2	482	73.1	16.4	35.8
1971	596	286	48.0	423	71.0	9.8	28.7
1972	625	219	35.0	510	81.6	10.3	28.8
1973	662	218	32.9	516	77.9	16.6	31.7
1974	729	233	32.0	584	80.1	15.4	28.4
1975	785	251	32.0	625	79.6	18.6	27.3
1976	840	288	34.3	646	76.9	16.6	25.3
1977	950	380	40.0	741	78.0	22.2	28.9
1978	1,148	425	37.0	910	79.3	20.0	33.8
1979	1,657	514	31.0	1,336	80.6	67.0	39.3
1980	2,185	481	22.0	1,850	84.7	121.0	43.0
1981	2,009	558	21.4	2,054	78.7	115.0	41.0
1982 ^a	2,887	—	—	2,458	85.1	123.0	44.8
1983 ^a	3,265	—	—	2,612	80.0	145.0	40.9
1984 ^b	3,843	—	—	3,074	80.0	122.0	41.0

Source: Aerospace and Marine Branch, Industry, Trade and Commerce, April 23, 1982.

a. Aerospace Industries Association of Canada, 21st Annual Report, 1983.

b. Estimated.

\$3.3 billion, electrical and electronics for \$2.7 billion, vehicles \$0.8 billion and shipbuilding for \$0.7 billion.

During the 1980s the sale of military vehicles has been the fastest growing sector of the defence industry. Both the aerospace and the electrical and electronic sectors have shown growth, while the shipbuilding and general purchasing sectors have declined during the 1980s. The armaments sector has shown some growth from 1981 through 1983.

In terms of export sales to the United States the distribution by companies varies considerably. For example, in 1983 only two companies, General Motors Diesel Division and McDonnell Douglas Corporation, had sales in excess of \$100 million to the United States. Two other companies, Litton Systems and DAF Indal, had sales in the range \$50–\$100 million. Twelve other companies had sales exports to the United States in the range \$10–\$50 million. Based on these data, it would appear that no one company dominates exports to the United States.

The Aerospace Sector

The Canadian aerospace industry is the largest industrial defence sector. In 1983, sales for the sector totalled approximately \$3.2 billion, up from \$1.3 billion in 1978, and sales are projected to reach \$6.7 billion by 1987. The industry purchases products from some 5,000 suppliers and employs approximately 41,000 in the work force; between 100,000 and 200,000 other members of the work force derive part of their income from this sector. The aerospace industry is primarily concentrated in the Montreal-Ottawa-Toronto triangle.

The industry as a whole (civilian and military) tends to be primarily export-oriented. According to the AIAC, the industry “does not have a substantial domestic market base for Canadian indigenous products in either Defence or Civil fields. . . . Our industry must export to survive.”⁶¹

With respect to the future of the work force, the industry forecasts a \$3.0 billion increase in sales from 1983 through to the end of 1987, which will augment the work force by a total of 10,000 personnel. During this same period the industry forecasts that new capital expenditures will be in the range of \$150 million per year. This would constitute a substantial improvement over the capital expenditures that occurred during the 1970s (see Table 5-4).

Despite the healthy projection for the industry as a whole, the only commercial aircraft manufacturer in Canada is De Havilland, which manufactures the DHC-6 Twin Otter, the Dash-7, and the Dash-8. Canadair, with its Challenger series and the CL-215 water bomber, is the only supplier in the category of general aviation and utility aircraft. Canada does not have an indigenous or partially indigenous military aircraft manufacturing capability to produce high-performance military aircraft.

The last military aircraft produced in Canada was the CF-5, built under licensed production by Canadair.

From the perspective of the AIAC, the lack of a sophisticated military aircraft capability manifests itself in a number of ways:

. . . in our inability to maintain products in Canada that we did not design, nor develop nor even assemble; in the deterioration of vital contact between government, allied governments and industry as to discussing, planning and investing in future defence needs; in the loss of technology transfer in many of the latest manufacturing processes and techniques that accrue from defence work that can be applied to our commercial business; in the loss of a domestic base (user) from which the industry can finance and launch export marketing efforts.⁶²

The AIAC has pointed out that the percentage of defence-related work over the past 25 years has declined “to a dangerously low level.” The reason for this concern is that “the source and funding of technological development related to defence work is key to industry’s success. We are competing with nations that fully fund massive defence development programmes as part of their Industrial Development Strategy.”⁶³

In order to overcome the lack of an indigenous or partially indigenous capability to produce military aircraft, the industry has adopted a policy and a strategy of military specialization. Table 5-12 indicates sector specialization related to defence products and the lead companies involved.

At least eight military specialization subsectors can be identified: aircraft subcontracting, repair and overhaul of aircraft, surveillance systems, engines and engine repair, avionics/electronics, satellites/ground stations, simulators, and powered lift technology.

With respect to future technologies, which are the key to the industry, sector specializations relating to unmanned surveillance systems, avionics/electronics, satellites/ground stations, simulators and powered lift technology deserve special consideration. As such, these military sectors should be nurtured and generated by way of government support, particularly by government support for research and development.

The Shipbuilding Sector

The shipbuilding and ship repair sector differs substantially from the aerospace sector in terms of size, ownership, volume of production, market orientation, and potential for defence procurement.

The Canadian Shipbuilding and Ship Repair Association (CSSRA) represents 23 Canadian ship and ship repair firms and 69 allied industries that provide infrastructure support to the industry. These firms account for 97 percent of all ships of 100 tons or more built in Canada, and these companies are 95 percent Canadian-owned.⁶⁴

Between 1974 and 1983 the total production value from the industry

TABLE 5-12 Aerospace Industry Military Sector Specialization

Sector Specialization	Lead Companies
Aircraft subcontracting	Fleet Industries Bristol Aerospace Enamel & Heat Canadian Aircraft Products Boeing of Canada Canadair
Aircraft repair and overhaul	Various
Surveillance systems (unmanned)	Bristol Aerospace Irvin Air Chute Canadian Marconi Aviation Electric
Engines	Pratt & Whitney Canada Rolls-Royce Ltd. Orenda Canadian General Electric
Avionics/electronics	Canadian Marconi Computing Devices Garrett Manufacturing Leigh Instruments Litton Systems
Satellites/ground stations	Spar Aerospace
Simulators	CAE Electronics
Powered lift technology	De Havilland

Source: Aerospace in Canada: Outlook and Strategy, 1983.

amounted to \$5.76 billion, with an average of 70 percent for new construction and 30 percent for repairs and conversions (see Table 5-13). Since 1977 this average has been relatively constant, but in earlier years new construction averaged 80 percent of total value. The annual dollar value has varied considerably over the past seven years, from a high of \$950 million in 1982 to a low of \$466 million in 1977. According to the CSSRA “the full force of the eight-year crisis in shipbuilding has finally arrived in Canada” given “the world economic situation and the consequent over-capacity in shipbuilding.”⁶⁵ Hence the drop in value production in 1983 to \$586 million.

The Canadian Patrol Frigate (CPF) program will improve the economic situation for the industry, but over the last decade no new major naval ships have been constructed, and the percentage value of government (civilian ships) contracts averaged only 7.5 percent on an annual basis,

**TABLE 5-13 Canadian Shipbuilding and Ship Repair,
Value of Production, 1974-83**

Year	New Construction		Repairs/Conversions		Total
	\$000	%	\$000	%	\$000
1974	248,711	80.0	62,145	20.0	310,856
1975	248,711	80.5	89,410	19.5	310,856
1976	349,868	79.9	88,222	20.1	438,090
1977	335,328	72.0	130,636	28.0	465,964
1978	350,870	71.1	142,444	28.9	493,314
1979	398,210	68.8	180,978	31.2	579,188
1980	476,651	69.7	207,108	30.3	683,759
1981	481,782	60.6	313,700	39.4	795,482
1982	652,918	68.8	296,228	31.2	949,146
1983	381,743	65.1	204,222	34.9	585,965
Total	4,045,081	71.6	1,715,093	28.3	5,760,174

Source: Canadian Shipbuilding and Ship Repair Association, *Annual Statistics Report*, 1983.

i.e., the industry has been almost exclusively dependent on commercial construction.

However, the government repair and conversion value on an annual basis since 1974 has averaged 24 percent. According to the CSSRA, naval refits constitute a major element and rose to 27 percent of total repair value in 1982: "Federal work is often the difference between staying in business or going out of business."⁶⁶

Unlike the aerospace sector, shipbuilding and repairs are heavily dependent on the domestic market. Table 5-14 indicates that on an annual basis between 66 percent and 80 percent of production value has been domestic-dependent. When distinctions between new construction and repair/conversions are made, the former relies more heavily on the foreign market, while the latter relies almost exclusively on the domestic market.

Given the economic state of the industry, employment levels have fluctuated from a high of 16,072 in 1974 to the current low of 11,300. However, the industry employs 50 percent skilled, 25 percent semi-skilled tradespeople and 20 percent white-collar workers. Only 5 percent of the work force is made up of unskilled labour.⁶⁷

From the perspective of defence-related products the future of the shipbuilding industry depends upon government approval of Phases II and

**TABLE 5-14 Canadian Shipbuilding and Ship Repair:
Production Value by Market, 1979-83**

Year	Domestic		Foreign		Total
	\$000	%	\$000	%	\$000
Total Value of Production					
1979	384,903	66.4	194,285	33.6	579,188
1980	503,777	73.7	179,982	26.3	693,759
1981	638,488	80.3	156,994	19.7	795,482
1982	647,657	68.2	301,489	31.8	949,146
1983	450,898	76.9	135,067	23.1	585,965
New Construction Value					
1979	229,762	57.7	168,448	42.3	398,210
1980	330,706	69.4	145,945	30.6	476,651
1981	353,834	73.4	127,948	26.6	481,782
1982	392,856	60.2	260,062	39.8	652,918
1983	266,115	70.0	115,628	30.0	381,743
Repairs/Conversions Value					
1979	115,141	85.7	25,837	14.3	180,978
1980	173,071	83.6	34,037	16.4	207,108
1981	284,654	90.7	29,046	9.3	313,700
1982	254,801	86.0	41,427	14.0	296,228
1983	184,783	90.5	19,439	9.5	204,222

Source: Canadian Shipbuilding and Ship Repair Association, *Annual Statistical Report*, 1983.

III of the Canadian Patrol Frigate (CPF) program. With the cabinet decision to proceed with Phase I of the program, the government adopted a consortium approach so as to “improve Canadian technological capacity through the transfer of technology and by using Canadian resources to perform the maximum practicable project management, ship design and construction, systems design and analysis, electronics system integration, production and test work in Canada.”⁶⁸ As a result, Saint John Shipbuilding Limited, a consortium of Saint John, N.B., won the contract over Scan Marine of Longueuil, Quebec. In addition, Paramax Electronics of Montréal, a subsidiary of Sperry Incorporated, was established for the management, design and integration of the combat systems, which will be primarily purchased offshore. The government’s approach encouraged the development of Canadian-based joint ventures.

The CSSRA has stated that the sail-away cost for each frigate will be approximately \$173 million in 1981 dollars, for a total of just over \$1 billion of the \$2.5 billion contract price, which compares favourably with British and German frigates of an equivalent class. Of the sail-away cost, 25 percent is estimated for shipyard work, i.e., \$2.58 million over 10 years, which represents 7,000 person-years of work, 24,000 person-years for allied

industry work, and approximately 2,000 person-years of foreign work abroad, mainly for the weapon systems.

Three of the frigates are being constructed in Saint John, N.B., three by Marine Industrie Limitée of Sorel, Quebec. Deliveries are scheduled between February 1989 and March 1992. If the cabinet approves the second phase of the CPF program, some of the ships will probably be constructed on the west coast.

Defence Industries in Perspective

The difficulty of collecting and analyzing data on Canadian defence industries suggests that the government would be well advised to direct Statistics Canada to develop a more comprehensive data collection and analysis package on the economics of defence. This process would be facilitated if all Canadian-based companies with defence sales, both domestic and export, were required to report their sales through an appropriate public mechanism.

Based on the data in this chapter, it is possible to identify eight underlying characteristics of Canadian-based defence industries.

1. Canada has no industrial-military complex comparable with that of the United States.
2. The impact of Canadian defence industries on the national economy is minimal in terms of percentage of GNP, percentage of trade, and percentage of the overall work force.
3. The industry is composed of only a few large companies with sales over \$100 million per year: that is, the majority of the companies in the industry are relatively small.
4. The industry is approximately 50 percent foreign-owned with significant federal government participation in two of the larger aerospace companies.
5. The industry is very heavily dependent upon the export market, primarily the United States.
6. The industry is, in the main, highly specialized, primarily in the area of aerospace electronics and communications.
7. The only indigenous/partially indigenous complete-systems capability exists in the shipbuilding and ship repair industries and, to some extent, in industries that produce wheeled land vehicles.
8. The industry is not capable of meeting the military requirements of the Department of National Defence, nor is it structured to do so.

Defence Procurement and Economic Policy: The Major Issues

The future of relations between government and defence-related industry is in part a function of the extent to which the government commits itself to defence on a continuing and long-term basis. If the government deems defence to be a high political priority, then the economic aspects of equipment procurement and the Canadian industrial defence base should be reassessed.

The defence interface between government and industry includes five areas of particular significance: the industrial defence base; the government-Department of National Defence procurement strategy; research and development (R&D) requirements; the Defence Production Sharing Agreement (DPSA) and trade with the United States; and industrial benefits.

The Industrial Defence Base

Does the government deem it important to establish explicit linkages between defence policy and an industrial defence base? Current linkages are limited, given the lack of an appropriate government strategy; the current utilization of funds for defence industrial enhancement programs; and the existing government structure for policy implementation.

According to the Aerospace Industries Association of Canada (AIAC):

The linkage between defence policy and the defence base has almost been lost [emphasis added]. DND has a need for industrial support. However, it has no mandate. The mandate, the Defence Product Act, is in Supply and Services. They have no money. Moreover, it is inconsistent with their service agency role. The funds are with Regional Industrial Expansion under the mantle of industrial support programs. These programs, however, are influenced more by regional and export factors than by defence considerations as they very well should be. In addition, the policy framework within which defence oriented support programs operate, resides in External Affairs. . . .

What we have then, appears to be an incoherent and unmanageable situation with respect to defence preparedness and its relationship to defence policy. . . .

[Departmental] reorganizations were made for a good reasons but the side effect has been a complete disintegration of any compatibility between defence and industrial policy. . . .

This fragmentation manifests itself in many ways . . . transportation policies which do not consider defence or national security requirements, inconsistent weapon procurement strategies, decline in the number of joint weapons systems projects undertaken in concert with our allies, an apparent lack of defence preparedness considerations in the development of trade and industrial policy, together with a gradual re-orientation of defence industrial base support programs. The end result is a weakening of our defence industries.⁶⁹

These criticisms do not mean, necessarily or logically, that the Canadian government should attempt to develop an indigenous defence industry whose prime purpose would be to meet the equipment requirements of the Canadian Forces. *A Canadian-based defence industry for the Canadian Forces is not viable on either economic or technological grounds.* However, explicit linkages between defence policy and Canada's defence sector can be supported on both military and economic grounds.

From the military perspective, at least three factors are significant. First, there has been the shift in DND policy from the concept of forces-in-being to the total-force concept. The DND⁷⁰ has stated that military doctrine and plans must be broadened to include more than the regular forces. This reflects the changing assessment within the Western Alliance regarding deterrence credibility and the need to place greater reliance on conventional deterrence. From this perspective, therefore, explicit defence-industry linkages are required for conventional force readiness and sustainability. Second, it is important for Canadian Forces requirements to maintain life-cycle support for equipment. Third, and linked to the above, is the need to enhance military preparedness by way of greater emphasis on industrial mobilization in order to reduce dependence on foreign sources of military supplies.

From an economic perspective, at least five factors support the argument for closer and more explicit linkages between defence and industry. First, DND capital expenditures account for nearly half of the total federal government capital expenditures and thus, in reality, DND is the lead department. Second, DND capital expenditures are, in the main, at the leading edge of technology and there could be a positive spillover into non-defence sectors. Third, a closer defence-industry interface would increase the capability of government and industry to participate in joint ventures with other countries. Fourth, closer relations would give military R&D a Canadian orientation and make military R&D relevant to future Canadian defence requirements and acquisitions. Fifth, Canadian defence procurement policy and procurement strategy could assist industrial strategy (should one be adopted).

The above points suggest that the DND should assume responsibility as the lead department for the industrial defence sector. This would allow for the evolution of the industrial base in Canada to meet Canada's defence requirements in a more effective manner.

Procurement Policies

DND's procurement strategy currently functions at cross-purposes with the general procurement policy of the federal government. The Procurement Review Mechanism (PRM) has been established "to obtain lasting benefits from the federal procurement activity beyond the immediate impact of the procurement expenditure itself, toward the economic or social develop-

ment of Canada.”⁷¹ As a policy statement, this objective is laudable, but it raises serious problems for DND.

The DND’s policy statement notes that “the primary objective of DND procurement policy is to provide the materiel and facilities required for the maintenance of fighting capability in Canada’s Sea, Land and Air Forces. As a first priority the Canadian Forces must be suitably and adequately equipped and trained for combat.”⁷² Defence procurement must also obtain best value, provide equal opportunity to tender, further national socio-economic objectives, enhance the technological capability of Canadian industry, be compatible with NATO’s policy on standardization and interoperability, and not conflict with Canada’s commitments under GATT. In cases where these criteria are met, “preference normally will be given to the procurement of equipment which is proven and in production.”

DND’s primary procurement objective must take precedence if the Canadian forces are to be properly equipped but, given the lack of an indigenous Canadian defence industry, it conflicts with the primary objective of the government’s overall procurement policy, which is Canadian economic development. DND’s needs and preference for off-the-shelf procurement, which for the most part means offshore for major capital acquisition, unless built under licensed production, offers little in the way of long-term economic benefits for Canada.

These apparently incompatible objectives are partially reconciled, at least in theory, by the priority allocated to industrial benefits, which applies to most federal procurements. A major difficulty, as discussed below, is that the objectives of the DPSA and the objectives of industrial benefits operate at cross purposes.

It is not unknown for various government objectives to operate at cross purposes. Defence procurement versus general procurement would appear to be a case in point. If DND capital expenditures only accounted for a small fraction of total federal capital expenditures, the conflicting objectives would be less important. However, to base the PRM on a primary objective that is incompatible with DND procurement is unfortunate, given DND capital requirements. Yet to shift DND’s objectives to conform to those of the PRM would be unwise, given the implications for Canadian defence capabilities and the possible response from our allies. However, it may be appropriate for the objectives of the PRM to be modified to take into account the fact that the primary objective of DND defence procurement is to provide materiel and facilities for the Canadian Forces.

If DND is assigned responsibility as the lead department for the enhancement of Canada’s defence base industry, and if the PRM is modified to reflect the fact that defence procurement is unique, it would be incumbent upon DND to alter its objectives and procedures to offer greater scope for the participation of Canadian-based industry and Canadian-related products. For example, DND procurement strategy might reflect the following objectives in order of priority: to supply the Canadian Forces

with the infrastructure and equipment to meet declared defence commitments; to foster the development of a Canadian industrial defence base more directly related to DND equipment requirements; to assist and maintain national economic growth; to promote a defence export market; and to help overcome regional economic disparities.

In addition to the reformulation of DND's procurement strategy, the government and DND could encourage the development of more active Canadian industrial participation in defence procurement. Industrial participation could be facilitated by a clear statement of long-term Canadian defence equipment requirements. Given current DND policy, Canadian industry is placed at a disadvantage vis-à-vis foreign competitors. The major problem, according to the Aerospace Advisory Committee, is that the lack of lead time for defence products "makes it virtually impossible for Canadian firms to compete for a significant portion of major DND systems."⁷³ Since DND has a well established procurement process and a 15-year procurement program, further steps could be taken to inform industry of future requirements, even if some of the requirements change over time.

The DND-industry relationship could be improved if a mechanism were in place to ensure greater contact and, it is to be hoped, cooperation between the department and industry. One such mechanism could be the establishment of a defence procurement advisory committee reporting directly to the Minister of National Defence. The committee could act as a conduit between the department and industry, could liaise directly with the minister on an annual basis, and could have access to DND procurement plans as appropriate.

The Minister of National Defence should also consider the establishment of a DND-industry task force on joint ventures. Of the various procurement modes discussed above, the most promising may be joint ventures between Canada and other members of the Western Alliance.⁷⁴ The major purpose of the task force would be to identify those specializations in the defence sector which could benefit from joint ventures, and to offer recommendations regarding future industrial infrastructure developments that could enhance joint venture potential. If this procurement mode appears to be viable, then DND should incorporate joint ventures explicitly as part of the department's official procurement strategy.

Government-Supported Military R&D

Research and development source funding for all sectors of the Canadian economy is essential for Canada's economic well-being. Without an adequate R&D source base Canada's position in an increasingly competitive and technological international environment will deteriorate.

The record of government and business alike in R&D source funding has been insufficient to ensure that Canadian industry remains at the leading

edge of technological change. The major industrialized states — the United States, France, West Germany and Japan — allocate between 1.5 and 2.5 percent of GNP to R&D. The Canadian government's 1981 guidelines targeted R&D funding at 1.5 percent of GNP with 50 percent from industry, 33 percent from the federal government and the remainder from the provinces, universities and other sources, for a 1985 total of \$7.6 billion. Current total R&D funding in Canada from all sources is less than 1 percent of GNP, and the probability of substantial increases appears unlikely.

Military R&D reflects the same trend as overall R&D, namely, underfunding. The Aerospace Advisory Committee has argued that "R&D is the most critical element in the maintenance of a viable aerospace industry. Without R&D, there would be no product development, and eventually no new products."⁷⁵ The committee noted that there is potential for extensive military R&D by industry, but a "continuation of the present situation will further reduce industry competitiveness in the world market, and eventually lead to its demise." The aerospace industry target for R&D is 10 percent of sales (in 1983 nearly \$300 million — on \$3 billion in sales) but no specific percentage has been allocated for military R&D. If the government takes steps to link defence procurement more closely to Canadian sources, then industry should allocate greater funds to R&D.

Government-funded military R&D comes primarily from DND and from the Department of Regional Industrial Expansion (DRIE).

The DND target for R&D is 5 percent of the capital component of the defence budget, which should be \$95 million for 1983–84 and \$116 million for 1984–85. According to capital expenditures, as stated in the estimates, DND has allocated \$79.5 million for development in 1983–84 and \$114 million in 1984–85. This does not represent the total DND effort for R&D, but the above figures are less than 2 percent of the capital budget.

According to *Defence 1983*, the primary purpose of DND R&D "is to provide effective and timely scientific and technological support to the CF [Canadian Forces] in performing their roles and to DND in meeting its objectives."⁷⁶ It should be noted, however, that DND has no R&D funding for industry. Over the years, DND gradually withdrew from funding industrial R&D. One of the functions of the Defence Research Board (DRB) had been to support industry-based applied research, but with the demise of the DRB and the elimination of the Defence Industrial Research (DIR) program, DND support for industrial R&D ceased in 1974.

The DIR program was relatively modest (\$4.5 million in 1974), and provided for shared cost (50:50) R&D funding between DND and industry. According to the department, the program was terminated "because of restraint in departmental spending."⁷⁷ According to the AIAC "the continuous degradation of DND's role in Industrial Development led to this program's demise. . . ." The AIAC has argued that without a DIR-type program "the valuable link between Defence Scientists and Planners and Industry weakened because the funding of R&D was no longer under control

of DND. DND no longer appeared to have much freedom to do basic research and work closely with the private sector. DND still needs its own program.”⁷⁸

Of considerably greater importance to the industrial sector is DRIE's Defence Industry Productivity Program (DIPP).⁷⁹ DIPP originated in 1959 and operates in support of Canada's international defence-sharing agreements. The primary objective is “to enhance economic growth through the promotion of viable defence on defence-related exports.” A secondary objective is “to provide a Canadian defence industrial base” and finally “to develop and maintain a defence technological capability.”

DIPP allows for four types of assistance: R&D, source funding to start Canadian companies, capital assistance in support of modernization projects, and marketing feasibility studies. Eligibility criteria involve a cumulative sales revenue ratio related to the first five years of production between 10 and 20 per cent of the DIPP contribution. Individual negotiations are available for each project. Capital assistance contributions are normally not repayable, but there is a repayment program for other funds, which is negotiable.

DIPP funding was initially relatively modest (\$5 million), but expanded to \$25 million per year by 1960–61. During the 1970s, DIPP funding remained relatively constant at some \$45 million. As of 1981–82, however, the program more than doubled to \$87.9 million and by 1983–84 had again doubled to \$169.2 million. The 1984–85 estimates indicate a cutback of nearly \$40 million to \$130 million.⁸⁰

From the perspective of the aerospace industry, DIPP “represents an essential, flexible program which should be maintained.”⁸¹ The industry has, however, expressed concern that the 1981 DIPP guidelines placed too much emphasis on “mature technologies, in order to minimize overall risk.” Industry spokesmen would prefer that funds be channelled into areas of advancing technology.

If undue emphasis is placed on return on investment and if the allocation of funds is a function of ratio-to-sales, then the R&D aspects of the program are probably not given sufficient priority. A more serious problem is that the objectives of DIPP may no longer be appropriate. DIPP has been exclusively export-oriented and thus supports Canadian defence R&D requirements only indirectly. Furthermore, the development of a Canadian defence industrial base remains a secondary objective, and this should be reviewed.

If DND becomes the lead department for the Canadian-based defence sector, then the department should assume a greater role in military R&D funding for industry. Preferably, DND should assume responsibility for an expanded DIPP. If this is considered unfeasible then a second option would be for DND to reestablish funding for a DIR type program.

Irrespective of the organizational structure for military R&D, it is essential that R&D funds be allocated to meet Canadian defence requirements and

that industry be directly involved. This being the case, government-supported military R&D could be directed to Canadian defence requirements as well as to the export market. Rather than return-on-investment type formulas for R&D, two other approaches may produce better results: directed military R&D and/or a shared-cost formula approach.

Agreements with the United States

The Canadian-American defence development and production-sharing agreements constitute one of the most controversial aspects of bilateral relations. On the one hand, the DPSA has been criticized as a mechanism that integrates Canadian industry into the American “war economy.”⁸² On the other hand, the Department of External Affairs considers the DPSA as “one of the most successful international arrangements for solving economic problems associated with cooperation in common defence alliances.”⁸³ The core of the relationship revolves around the 1959 Defence Production Sharing Agreement (DPSA). There are also a number of relevant Canadian-American defence agreements dating back to the Hyde Park Declaration of 1941 through to the 1963 Memorandum of Understanding between the U.S. Department of Defense and the Canadian Department of Defence Production.

In 1959 Canada and the United States agreed that “Canadian industry would have equal opportunity to compete with U.S. industry for U.S. defence contracts on the normal commercial basis of price, quality and delivery.” In order to implement this principle, the American government eliminated restrictions on a wide range of Canadian supplies for U.S. defence programs from the “Buy American” act restrictions; and American government regulations were changed to allow Canadian military goods to enter the U.S. duty free.

The major underlying objective of the DPSA has been to “strive for the most effective utilization by Canada and the United States of their respective industrial resources for common defence, with the immediate objective of increased participation by Canadian industry in the production and supply of North American equipment requirements.” This agreement was deemed essential to the survival of the Canadian military aerospace sector, given the decision by the Diefenbaker government to terminate support for an indigenous military capability in the Canadian air industry. Furthermore, the DPSA was considered essential “if Canada was to be able to continue to purchase its majority of defence requirements from the United States.”

In 1963 the program was reviewed and the two governments agreed that an additional objective of the DPSA would be to maintain “a good long-term balance in reciprocal defence procurement at increasing levels.”

Table 5-15 outlines the extent of two-way trade under the DPSA. Total defence trade from 1959 through to 1984 has been approximately \$17.8

billion. From 1959 to 1980 the trade flows were relatively balanced, with a favourable surplus for the United States of \$339.4 million. Since the early 1980s, the balance in favour of the United States has grown steadily (\$207.2 million in 1981, \$434.5 million in 1982 and \$251 million in 1983) for a cumulative balance in favour of the United States of \$1.23 billion. Government officials and industry spokesmen appear relatively unconcerned with the balance in favour of the United States. However, the current trend is likely to accelerate, given DND's re-equipment program.

Even though government officials and industry spokesmen have expressed a considerable degree of satisfaction with the DPSA, there are a number of difficulties to be addressed. Over a number of years, various American administrations have instituted constraints on international cooperation that have affected defence trade, and Canada has not been immune from these developments. To date, more than eleven legislative acts of Congress have adversely affected Canadian access to the American defence market.

Current legislative limitations constitute significant constraints on Canadian access to the U.S. defence market.⁸⁴ It has been estimated that only 30 percent of the annual Department of Defense (DOD) procurement budget (some \$89 billion in 1983) was available for competition by Canadian industry on a continuing basis. Given the principles that underlie the DPSA, this degree of access to DOD's procurement budget is too restrictive.

Another problem identified by Canadian industry is access to the American market at the R&D phase. The Aerospace Advisory Committee recommended that "Canada negotiate participation in research and design study phase activity in selective defence technology areas with the United States."⁸⁵ Apparently this issue has been raised by Canadian government officials, but with little success.

On the Canadian side and at the ministerial level, successive governments have paid insufficient attention to the implications of the DPSA and its long-term effects on Canadian industry. The Canadian government might have appreciated more fully that its re-equipment program would constitute an imbalance in trade in favour of the United States and might have taken more concrete steps to circumvent the adverse trade trends that have appeared since the early 1980s.

The DPSA problems cannot be dealt with at the level of government officials, but require active intervention at the ministerial level and possibly even bilateral discussions between the Canadian and American heads of government. It may be that the Canadian government should propose ministerial level discussions to seek ways to resolve some of the existing DPSA problems, including the growing imbalance of defence trade in favour of the United States; the protectionist trend in the competition for U.S. defence products as the result of legislative constraints; the issue of Canadian access to U.S. military projects at the R&D stage; and the feasibility of government-to-government and/or industry-to-industry joint ventures in defence development and production.

TABLE 5-15 Canada-United States Defence Production Sharing Procurement, 1959-83

	1959-80	1981	1982	1983	Total 1959-83
	(Cdn\$ millions)				
United States Procurement in Canada					
Prime contracts	2,702.3	340.7	563.3	538.7	4,145.0
Subcontracts	2,493.2	485.9	464.6	668.8	4,112.5
Total	5,195.5	826.6	1,027.9	1,207.5	8,257.5
Canadian procurement in United States					
Prime Contracts	2,322.3	507.8	931.7	963.0	4,724.8
Subcontracts	3,212.6	526.0	530.7	495.8	4,765.1
Total	5,534.9	1,033.8	1,462.4	1,458.8	9,489.9
Cross-border balance					
In favour of the United States	339.4	207.2	434.5	251.3	1,232.4

Source: Defence Programs Branch, Department of External Affairs.

Industrial Benefits

One of the major government objectives of defence procurement has been to enhance Canadian economic development and growth through the use of industrial benefits. Four major defence procurement programs have involved industrial benefits: the long-range patrol aircraft (LRPA), the C-1 Leopard tank, the new fighter aircraft (NFA), and the Canadian patrol frigate (CPF). The government has thus acquired considerable experience in the area of industrial benefits.

At the outset it is important to distinguish between the underlying principles relating to defence procurement and the instruments to achieve objectives. The Procurement Review Mechanism (PRM) clearly states that the primary procurement objective is to enhance Canadian economic development by means of industrial benefits. However, the instruments to achieve this objective can vary considerably. Two broad types of instruments can be identified within the defence context: first, offsets which apply to prime offshore contractors when defence contracts are signed as in the case of the LRPA and the C-1 Leopard and, second, Canadian-content criteria, which apply to indigenous and/or semi-indigenous procurement programs. For example, the CPF contract contains both Canadian-content and offset requirements.

The LRPA program was the first real attempt to utilize defence procurement for the purpose of enhancing industrial benefits. With the Request for Purchase (RFP), Industry, Trade and Commerce officials drew up a series of broad objectives that included the need to maximize expenditures in Canada, to maintain employment on an increasingly competitive basis, and to provide both R&D and production with the broadest possible regional involvement. These objectives were general in nature, but the contracting conditions were elaborate.

In the case of the C-1 Leopard procurement, the industrial benefits package differed from the LRPA, as Canada has no tank industry and the purchase of 128 tanks had little impact on the total German production run of some four thousand. Consequently, offsets covered a range of Canadian manufactured products to be introduced into the Federal Republic of Germany. Industry, Trade and Commerce officials drew up a list of acceptable manufactured products, and orders had to be placed by the prime contractor with Canadian firms. The orders had to constitute new business and could not be repeat orders.

The most complicated industrial benefits package involved arrangements for the NFA. However, as in the case of the LRPA, the contending bidders were given no specific guidance or orientation in terms of particular types of benefits; instead, a number of eligibility criteria were laid down. For example, a benefit had to be generated by the prime contractor, its divisions, its first-tier subcontractors or the U.S. government; the benefit had to accrue to Canada after March 18, 1977; only the Canadian content of

benefits would be considered eligible for a credit; in the case of goods and services procured from Canada in the past, only increases over a base-line period would be considered; and benefits could not include raw materials and imported materials and services.

The Canadian Patrol Frigate program constituted a different approach to industrial benefits when compared with LRPA and NFA. In this instance major construction would take place in Canadian shipyards, a high level of direct employment would occur, and Canadian technology in terms of ship and system design would be utilized. Consequently, one of the specific requirements was the degree of Canadian content. Both offsets and Canadian content constituted criteria in the bids submitted by potential contractors.

On the surface, it would appear that defence procurement has produced substantial industrial benefits. Table 5-16 indicates the relationships between the contract price and the offset requirements including, where known, the implications for employment.

TABLE 5-16 Industrial Benefits and Defence Procurement

Program	Long-Range Patrol Aircraft	C-1 Leopard Tank	New Fighter Aircraft	Canadian Patrol Frigate
Prime contractor	Lockheed	Krauss- Maffei	McDonnell Douglas	Saint John Shipbuilding
Contract price (\$ million)	950 (1976)	187 (1976)	2,300 (1977)	2,400 ^a (1983)
Project cost, 1984 (\$ million)	1,169	256	4,928	5,516
Offset requirements (\$ million)				
Firm	914	74.8	2,910 ^c	763
Best effort	522	37.4		
Time frame	1975-95	1976-86	1977-95	1983-92
Employment — person-years	not known	minimal	60,000- 70,000	30,230

Sources: Minister's statement, *Defence Estimates 1984-85*; Minister of Industry, Trade and Commerce, statement on new fighter aircraft industrial benefits, April 10, 1980; CP-140 Industrial Benefits Progress Report, 1982, Industry, Trade and Commerce; and Government of Canada press releases.

a. Canadian content set at 67 percent.

b. Constant dollars.

c. Real economic activity value projected at \$3,263 million.

For the LRPA, with the contract price of \$950 million (1976), the offset objectives agreed upon with Lockheed constituted 96.2 percent of the contract price and a further 54.9 percent on a best-effort basis. When both

the firm offset requirements and the best-effort basis were taken into account the total value of the offsets exceeded that of the contract price.

With the C-1 Leopard program, the Canadian government had less leverage, given the nature of the equipment purchased. Nevertheless, offset requirements constituted 40 percent of the contract price of \$187 million (1976) and a further 20 percent on a best-effort basis.

In the case of NFA, McDonnell Douglas agreed to firm offsets totalling \$2,910 million, based on a contract price of \$2,300 million (1977). The total offset package, in terms of projected real economic activity, was \$3.263 million. Based on total offsets, the dollar value agreed to by McDonnell Douglas represented 126.5 percent of the contract price, and the industrial benefits are expected to produce between 60,000 and 70,000 person-years of employment.

For the CPF, with a contract price of \$2,400 million (1983), Saint John Shipbuilding Limited agreed to a Canadian figure of 67 percent and firm offsets totalling \$763 million (31.8 percent of the contract price). The program is expected to produce some 30,000 person-years of employment with regional distribution as follows: 8,000 in the Maritimes, 12,000 in Quebec, 8,000 in Ontario and 2,000 in the West.⁸⁶

The industrial benefits of defence spending can be assessed in terms of their direct, indirect and induced impacts on the Canadian economy.⁸⁷ Based on these distinctions, direct defence contract values in 1981 of \$784 million generated indirect economic activity of approximately \$596 million and induced benefits of a further \$355 million. Thus the Defence department has argued that

defence activities stimulate Canadian economic growth and the employment opportunities which are made available to Canadians everywhere. It has been estimated that one job is created for every additional \$20,000 to \$29,000 spent on defence.⁸⁸

DND has thus projected that defence expenditures in 1984-85 will generate approximately 240,000 person-years of employment.

On the surface it would appear that Canadian defence expenditures, including defence procurement, offer considerable industrial benefits to Canada. Nevertheless, the relationship between industrial benefits and defence procurement raises a range of complex issues.

Although the evidence is fragmentary, a number of criticisms have arisen regarding industrial benefit objectives. For example, industry has generally been left free to propose the benefits package in each of the major procurement projects. In the case of the NFA contract 10 percent of the offsets were allocated to tourism development. This caused a number of difficulties relating to contract administration and raised questions for DPSA counting criteria. In the Leopard contract, the listing of acceptable manufactured products for offsets offered little scope for developing new technologies.

More important, it would appear that the nature of the benefits produced

by defence procurement have only had limited impact on the development of viable defence industries. While the dollar figures outlined in Table 5-16 have, to date, been met and, from this perspective, the programs may be judged a success, the more important aspects of the PRM objectives have not been met. There have been serious concerns about the relatively low level of technology transfers, about the limited impact on regional development, and with the politicalization of the defence procurement process.

Table 5-17 outlines the regional distribution of defence industrial benefits for the LRPA, the NFA and the CPF. In each case the data indicate that the vast majority of the benefits have gone to Ontario and Quebec. The one exception is the CPF where the Maritimes should benefit from the 26.9 percent of the contract price to be expended in the region.

TABLE 5-17 Regional Distribution of Defence Industrial Benefits

Region	Long-Range Patrol Aircraft ^a		New Fighter Aircraft ^b		Canadian Patrol Frigate	
	\$ million	%	\$ million	%	\$ million	%
Ontario	309.9	49.4	1,296	39.7	640	26.4
Quebec	243.9	38.8	1,573	48.2	973	40.2
Maritimes	17.2	2.7	394	12.1	650	26.9
Western Canada	56.8	9.0			157	6.5
Total	627.8	99.9	3,263	100.0	2,420	100.0

Sources: Minister’s statement, *Defence Estimates 1984–85*; Minister of Industry, Trade and Commerce, Statement on new fighter aircraft industrial benefits, April 10, 1980; CP–140 Industrial Benefits Progress Report, 1982, Industry, Trade and Commerce; and Government of Canada press releases.

- a. To mid-1982, with total orders of \$638.1 million, \$ 10.3 million not identified by region.
- b. Based on projected real economic activity figure.
- c. Based on projected distribution of contract price.

The data suggest that the utilization of the PRM to redistribute industry across Canada has not been effective. The high-technology industries that are defence-related are located primarily in Ontario and Quebec. The one exception is the shipbuilding industry, because of the location of the major shipyards. At best, the PRM objectives, as they relate to defence procurement and regional distribution, will have an impact only at the margins.

There have also been a number of problems identified with the contract process itself, and these should not be understated. If the Canadian government is to continue the existing practices and procedures, then it must find ways of improving the contracting process which, in turn, could benefit industry.

Within the context of this report, however, the implications of industrial benefits for defence procurement deserve particular consideration, and three points should be noted.

First, is the major purpose of acquiring defence equipment to ensure the security of Canada and the Western Alliance? Or is it to enhance industrial benefits? To date it would appear that there has been undue emphasis placed on industrial benefit considerations to the detriment of defence considerations. If industrial benefits become the primary factor behind defence procurement, there is a danger of acquiring equipment not suited for Canadian defence requirements. This in turn, could have an adverse impact on defence capabilities. The acquisition of CF-5 aircraft was a case where industrial benefit considerations appeared more important than warranted.

Second, the industrial benefits emphasis appears to add to the cost of defence procurement. DND pays a premium for the objectives and approach outlined in the PRM. In cases where premiums arise from defence procurement as a result of industrial benefits objectives unrelated to the establishment of a Canadian defence industrial base, the government should allocate the premiums from sources other than the defence budget.

Third, the current emphasis on industrial benefits adds to the length of the procurement process. The contracts are much more complex to negotiate, given the PRM. This has hidden cost in terms of the inflation of defence products and as a result of the slowness of the procurement process.

A major unanticipated set of problems relating to the offset approach to defence procurement has been the politicization of the process. Politicization has been apparent in terms of the behaviour of the prime contractors, of interprovincial and federal-provincial relations, and of federal non-defence compensatory resource allocations.

The NFA program, with a project cost of \$5.5 billion, is a good case study of the extent to which defence procurement can become highly politicized. The two NFA finalists, McDonnell Douglas and General Dynamics,⁸⁹ undertook major advertising campaigns to extol the virtues of their particular aircraft and the economic worth of their respective offset packages. General Dynamics resorted to an aggressive and, according to some observers, misleading campaign. This led to the release of the government's assessment of the offset packages, which showed McDonnell Douglas at \$3.26 billion compared with \$2.62 billion for General Dynamics.

The industrial benefits components of the contracting process allowed the major contributors to make public claims that were difficult to evaluate and led to interprovincial competition and preferences. Premier Lévesque of Quebec supported the F-16 on the grounds that the General Dynamics package had a higher Quebec content than the McDonnell Douglas package.

The issue of regional distribution has not, of course, been limited to

the NFA contract. In the case of all procurement decisions, politics can be a central factor in selecting the prime contractor, and the personal preferences of individual ministers can have a significant impact. Since greater regional diversification and the reduction of regional disparities is a declared objective of the PRM, the actions of individual ministers are congruent with government policy, even if the end result reduces the cost-effectiveness of defence equipment. If prime contractors and subcontractors have to be concerned (as they do) with the geographical distribution of the benefits package and link this to the federal constituencies of certain ministers (which they should do if they understand Canadian politics), the cost of defence procurement can be adversely affected.

The most significant and unintended aspect of the PRM may be the relationship between defence-related industrial benefits and the allocation of resources in other policy areas by Ottawa in order to compensate for the regional impact of defence procurement. For example, at the time of the NFA contract Ottawa was contemplating a \$750 million commitment to Chrysler (located in Ontario). To reject General Dynamics' offset package and at the same time support Chrysler in Ontario would have appeared either neglectful or discriminatory toward Quebec. In order to compensate Quebec, a number of decisions were announced by Ottawa, which allocated funds (current and potential) to support provincially based industry. These projects and monies might have been allocated to Quebec in any case, and thus the linkage to the NFA contract may not be as explicit as suggested. Nevertheless, there is no doubt that the industrial benefits aspect of the PRM allows defence procurement to become an important component of the political game.

A further consideration regarding defence procurement and industrial benefits involves the international implications of current government policy and practices. The 1983 DEA report, *A Review of Canadian Trade Policy*, noted that:

other countries have developed similar practices and have, in some cases, sought offsets deriving from their purchases of Canadian defence equipment. In general, buyers requesting countertrade (offsets, counterpurchase, co-production, etc.) as a condition of purchase are motivated by a desire to acquire new technology and production while simultaneously reducing the foreign exchange drain involved in the purchase. . . .

It is the fact of international trade that in the defence sector countertrade is being increasingly sought, including in areas where Canada is in a position to export some of its indigenous advanced-technology products. It is an open question, therefore, whether this practice has outlived its usefulness.⁹⁰

The countertrade implications, given Canadian policy, are serious. Within the defence context, it should be appreciated that Canada currently has a trade surplus with all countries except the United States. Continued use of offsets will place Canadian defence-related industry in jeopardy.

Countertrade has become an irritant to Canada's trading partners, and countertrade proposals are increasingly being linked to the sale of Canadian products abroad. If, in the case of the United States, American companies and the American government apply industrial offsets to their defence products, there could be a further negative shift of the balance of trade under the DPSA.

Concerns have been expressed in the United States, given the relationship between PRM industrial benefits objectives on the one hand and the underlying principles of the DPSA on the other. The former is primarily a protectionist approach to defence procurement as the PRM places additional conditions on foreign prime contractors that do not exist within the DPSA context. The DPSA is based on the principle of unrestricted access to the Canadian defence market.

Countertrade also has serious implications given the structure and nature of Canadian defence industries. Since the defence industry is primarily export-oriented and its firms are relatively small and undiversified judged by world standards, it is next to impossible for the majority to respond to countertrade proposals from abroad.

This latter point is particularly important, since the Canadian government has no mechanism in place to support industry when countertrade proposals are demanded from abroad. If the government insists on an offset approach to defence procurement, then it should develop a countertrade policy in support of Canadian defence-related industries.

Given these problems, it may be appropriate for the government to announce that the application of offsets as a means to attain industrial benefits from defence procurement will be terminated with the completion of existing contracts. In addition, the Canadian government should announce that it will no longer seek countertrade from other governments and/or prime contractors for future defence procurements, and that countertrade benefits for future Canadian defence export sales will not be offered.

Concluding Observations

Defence has emerged as a significant public policy issue in Canada. The Conservative government has declared that Canada will place greater emphasis on defence than in the past and that Canadian commitments to the Western Alliance will be fulfilled in a credible manner. The prospects for consistent and sustained resources allocations for defence should be enhanced.

In the first instance, however, resources for defence should be placed within the context of declared defence commitments. This suggests that the government may wish to develop a commitment-capability funding model for resource allocations in order to balance commitments and capabilities and to make an effective contribution to deterrence.

The need for continued defence procurement offers the government the opportunity to develop a procurement strategy which, at least in part, can assist Canadian defence-related industries to meet the future equipment requirements of the Canadian Forces in a more effective manner. This objective could be consistent with an expanded export market, if defence economic relations with the United States are revitalized through the Defence Production Sharing Agreements (DPSA). This may require a substantial revision of current policy vis-à-vis industrial benefits in such a manner that federal procurement policy is consistent with the free trade objectives of the DPSA. In the process, however, the Conservative government should constantly bear in mind that, in the first and final analysis, resources for defence are to purchase national and international security.

Notes

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 16. For example, the future of military cooperation between Canada and the United States in outer space will raise important policy and economic issues. See Brian MacDonald, ed., *Strategies for Space* (Toronto: CISS 1983).
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 18. For studies on Canadian defence, see Colin Gray, *Canadian Defence Priorities: A Question of Relevance* (Toronto: Clarke, Irwin, 1972); and Brian Cuthbertson, *Canadian Military Independence in the Age of the Superpowers* (Toronto: Fitzhenry and Whiteside, 1977) as well as various issues of *Canadian Defence Quarterly*.
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 20. Canada, *White Paper on Defence* (Ottawa: Queen's Printer, 1964).
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 23. Canada, House of Commons, Standing Committee on External Affairs and National Defence, *Report on Security and Disarmament* (Ottawa: April 1983); and CIIA Working Group Report, *The Other Road to Security: Canada and Disarmament* (Toronto: Canadian Institute of International Affairs, 1982). No consensus exists on how to address East-West issues. See R.B. Byers and Stanley C.M. Ing, "Approaches to Arms Limitation and Policy Preferences," in *Arms Limitation and the United Nations*, The Polaris Papers 1, edited by R.B. Byers and Stanley C.M. Ing (Toronto: CISS, 1982), pp. 3–21.
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25. Minister's Statement, *Defence Estimates, 1984/85* (Ottawa: House of Commons Standing Committee on External Affairs and National Defence, 1984), p. 7. Also see *Defence in the 70s*, p. 6.
26. The Canadian Peace Movement has been particularly vocal on nuclear-related issues which affect Canada. See Carole Giangrande, *The Nuclear North: The People, the Regions and the Arms Race* (Toronto: Anansi, 1983). For the view of church leaders, see "A Statement on Canada's Nuclear Weapons Policy," brief presented to Prime Minister Trudeau, Ottawa, December 13, 1982; and "Brief on Peace and Disarmament," brief presented to Prime Minister Trudeau, December 14, 1983. *The Ploughshares Monitor* published by Project Ploughshares, Waterloo, Ontario, contains a wide range of articles related to defence and disarmament.
27. On Mr. Trudeau's peace initiative, see articles by Adam Bromke and Kim Richard Nossal, and by Michael Tucker in *International Perspectives* (May-June, 1984).
28. R.B. Byers, "Political Confidence-Building and Strategic Coherence: Trudeau's Peace Initiative," in *Nuclear Strategy and the Superpowers*, edited by R.B. Byers (Toronto: CISS), pp. 116-31.
29. Public opinion data indicates that Canadians are concerned about the state of East-West relations and the dangers of nuclear war. See R.B. Byers and D. Munton, "Canadian Defence, Nuclear Arms and Public Opinion: Consensus and Controversy," paper presented to the Annual Meeting of the Canadian Political Science Association, Vancouver, June 1983.
30. For an overview of commitments and capabilities see *Defence Estimates, 1984/85*; and Department of National Defence, *Defence 83* (Ottawa: Minister of Supply and Services Canada, 1984).
31. Many analysts acknowledge the need to alter commitments, given current capabilities, but no consensus exists on this issue. For example, compare Byers et al., *Canada and Western Security*; Nils Orvik, *Northern Development and Security* (Kingston: Queen's University, Centre for International Relations, 1983); and Joel Sokolsky and Joseph T. Jockel, "Canada: The Not So Faithful Ally," *Washington Quarterly* 7 (Fall 1984), pp. 149-69.
32. See note 5. The Senate reports assume that Canada would retain existing commitments.
33. *Canada's Maritime Defence*, p. 2. See also Joel Sokolsky, "Canada and the NATO Maritime Alliance," *Conflict Quarterly* (Spring 1984), pp. 5-28.
34. C.J. Marshall, "Canada's Forces Take Stock in Defence Structure Review," *International Perspectives* (January-February 1976), pp. 26-30.
35. Department of National Defence submissions to cabinet have informed the government of this problem. *Calgary Herald*, April 14, 1984.
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37. Canada, House of Commons Standing Committee on External Affairs and National Defence, Minister's Statement, *Defence Estimates: 1983/84*, (March 15, 1983), p. 2.
38. *The Economic Impact of Canadian Defence Expenditures*, pp. 163-205.
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42. Middlemiss, "The Department of National Defence."
43. This section draws on Danford D.W. Middlemiss, "The Pitfalls of Formula Funding," *Canadian Defence Quarterly* 12 (Winter 1982/83), pp. 24-29.

44. Marshall, "Canada's Forces Take Stock in Defence Structure Review."
45. Canada, Department of National Defence, *1984-85 Estimates*, Part 3, Expenditure Plan (Ottawa: Minister of Supply and Services Canada, 1984).
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50. James Dow, *The Arrow* (Toronto: James Lorimer, 1979).
51. With the cancellation of the Bras d'Or program the Canadian government closed off the option of having a partially indigenous naval procurement program in hydrofoils.
52. Peyton V. Lyon, *Canada and World Affairs, 1961-63*.
53. Treasury Board Canada, *Administrative Policy Manual*, Procurement Review, chap. 305 (Ottawa: Minister of Supply and Services Canada, March 1980).
54. The structure and process of equipment acquisition has been addressed elsewhere. Canada, Department of National Defence, *An Introduction to the Defence Services Programs* (Ottawa: DND 1981), pp. 1-2. See also Col. W.N. Russell, "The Management of Canada's Defence Resources," *Canadian Defence Quarterly* 13 (Spring 1984); and *Canada's Maritime Defence*, pp. 63-67.
55. Franklin C. Spinney, *Defense Facts of Life: The Plan/Reality Mismatch*. (Boulder, Colo.: Westview Press, 1985).
56. David Cox, "Defence Procurement, Defence Budgets and Canada's European Defence Commitments," paper presented to the Conference on Arms Control, Disarmament and Defence Policy, "Assessing Canada's Role in the 1980s," Kingston, Queen's University, November 1984.
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60. See data contained in Canada, Department of Regional Economic Expansion, Report of the Advisory Committee on Aerospace Development, *Aerospace in Canada: Outlook and Strategy* (Ottawa: DREE, July 1983).
61. Ibid. See also Canada, Senate Special Committee on National Defence, *Minutes of Proceedings and Evidence*, March 14, 1984, p. 4a:5.
62. Ibid.
63. Ibid.
64. Canadian Shipbuilding and Ship Repairing Association (CSSRA), brief submitted to the Royal Commission on the Economic Union and Development Prospects for Canada, Ottawa, December 12, 1983.
65. CSSRA, *Annual Statistical Report, 1983* (Ottawa: 1983), p. 3.
66. Canada, Senate, Subcommittee on National Defence, *Minutes of Proceedings and Evidence*, March 8, 1983, p. 40:7.
67. Ibid. The material on the CPF is based on this reference.

68. Ibid., p. 40:14.
69. Canada, Senate, Special Committee on National Defence, *Minutes of Proceedings and Evidence*, March 14, 1984, p. 4A:13. See also W.J. Yost, *Canada's Industrial Mobilization Capacity* (Ottawa: Conference of Defence Associations, 1983), pp. 2-3, hereafter cited as *Yost Report*.
70. *Defence Estimates 1984/85*, p. 53.
71. *Administrative Policy Manual*, p. 5.
72. DND Procurement Policy, NDHQ Policy Directive P. 16 (Issue 2), (September, 1981).
73. *Aerospace in Canada — Outlook and Strategy*, p. 7-5, and Canada, Senate, Subcommittee on National Defence, *Minutes of Proceedings and Evidence*, March 8, 1983, p. 40:15.
74. There are indications that the joint venture approach is being adopted with greater frequency. For example, in the case of the Low Level Air Defence (LLAD) contract, several joint venture consortia have been established (British Aerospace and Garrett Manufacturing Limited, Euromissile and Spar Aerospace).
75. *Aerospace in Canada — Outlook and Strategy*, p. 4-37.
76. See *Defence 83*, pp. 104-107, for an overview of the R&D structure and activities.
77. Department of National Defence, *Defence 75* (Ottawa, 1976), p. 91.
78. *Proceedings of the Special Committee of the Senate on National Defence*, Issue no. 4 (March 14, 1984), pp. 4A:11-12.
79. References to the DIPP Programme may be found in the *Yost Report*, Annex D.
80. Data drawn from Public Accounts.
81. *Aerospace in Canada — Outlook and Strategy*, p. 4-37.
82. For criticisms of the DPSA see Gideon Rosenbluth, "Canada's Role in the Nuclear Arms Race," and Joel Mihevc, "The Case for Conversion in Canada," papers presented to the Interfaith Program for Public Awareness of Nuclear Issues, Toronto, November 1984. For an earlier study of the Canadian defence industry see Ernie Regehr, *Making a Killing: Canada's Arms Industry* (Toronto: McClelland and Stewart, 1975).
83. See *Yost Report*, Annex C.
84. James C. Bradford, "Canadian Defence Trade with the U.S.," Workshop on US-Canadian Relations, University of Western Ontario, November 18, 1983.
85. *Aerospace in Canada — Outlook and Strategy*, p. 54. The issue of Canadian participation in the R&D phase of the Strategic Defense Initiative could be left to the arrangements of the DPSA.
86. *Defence Estimates 1984/85*, p. 54.
87. Treddenick, "Regional Impacts of Defence Spending."
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DENIS STAIRS and GILBERT R. WINHAM, Research Coordinators

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